ARTICLES

CORPORATE LAW PREEMPTION IN AN AGE OF GLOBAL CAPITAL MARKETS

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ABSTRACT

At the heart of the extensive literature on corporate-law federalism is the belief that federalism engenders regulatory competition and federalization eliminates it. Federalism, a mode of governance where states act as providers of corporate law, is said to drive states to compete for charters. By contrast, federalization, which occurs when the federal government promulgates law, preempts state-level competition. Consequently, scholars who believe that regulatory competition promotes the provision of "good" laws have long railed against federal securities statutes like Sarbanes-Oxley that nationalize elements of traditional (state) corporate law. Meanwhile, other scholars have lauded preemptive securities regulation, arguing that federal intervention prevents the dismantling of regulatory standards and a race to the bottom.

This Article argues that both sides of the debate mistake the impact of federalization on the market for corporate law. Drawing on recent legal and empirical scholarship, this Article shows that as a descriptive matter, the domestic market for corporate law is in some regards animated less by competition than by what is an increasingly international market for securities law. States generally do not compete vigorously to attract charters due to Delaware's longstanding domination of the market and other supply-side disincentives. At the same time, national securities

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regulators face intense pressure to provide cost-effective rules to draw foreign issuers to their home markets. These observations suggest that where federal regulators preempt, they are engaged in what can be considered a "doubled race." First, they must monitor for market failure and ensure that Delaware, the dominant supplier of corporate charters, provides sound corporate law. And second, they must themselves cope with the onslaught of competition from foreign national regulators seeking to attract securities transactions. As a result, preemption is a weaker counterweight to any competition arising among states than many scholars have anticipated.

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I. INTRODUCTION

Central to the literature on corporate-law federalism is the belief that while federalism engenders regulatory competition, federalization eliminates it. Federalism, a mode of governance where states act as providers of corporate law for in-state and out-of-state firms, is said to drive states to compete for corporate charters and incorporation fees.[1]

1. The impact of this competition is a matter of perennial debate. *See, e.g.*, William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974) (arguing that federalism engenders regulatory competition leading to a race to the bottom); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 255 (1977) (arguing that federalism encourages states to provide laws maximizing shareholder wealth and a race to the top). *See also* Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. Rev. 913, 921–22 (1982) (arguing that federalism incentivizes states to compete to create climates that encourage mutually beneficial contractual arrangements); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998) (arguing that federalism engenders efficiency-creating regulatory competition).

Meanwhile, federalization, the mechanism by which national authorities promulgate law, preempts state-level competition and enables federal regulators to enjoy unchallenged power over the provision of law.[2] As a result, prominent scholars advocating regulatory competition have long railed against securities statutes like the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley")[3] that federalize key elements of traditional (state) corporate law like corporate governance.[4] In their view, such legislation removes the provision of law from a competitive corporate-law market and posits it in a market for securities law monopolized by national authorities who internalize few costs for their regulatory decisionmaking.[5]

This Article disputes this view and argues that preemptive securities regulation enables modes of regulatory competition that have been undertheorized in the dominant literature. Drawing on recent legal and empirical scholarship, it asserts that the market for securities law is in fact animated by more competition than the market for corporate law. Because of network externalities and supply-side barriers to entry, one state, Delaware, dominates the market for charters, and relatively little state-to-state competition is occurring. On the other hand, the proliferation and growth of international financial centers, along with low mobility costs for issuers, have increased pressure on regulators to provide the most attractive securities laws possible in order to draw foreign issuers to their domestic markets.

Consequently, this Article argues that preemptive securities regulation situates lawmaking in an overlooked legal marketplace with features that in

2. *See, e.g.*, Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES L. 387, 400 (2001) (describing the federal oversight by the Securities and Exchange Commission as a "monopoly over issuers"). *See also* Frederick Tung, *From Monopolists to Markets?: A Political Economy of Issuer Choice in International Securities Regulation*, 2002 WIS. L. REV. 1363, 1367 (2002) ("[B]ecause each national regulator insists on exclusivity in regulating the . . . trading of securities within its national borders, territoriality effectively grants each regulator a national 'monopoly' on regulation.").

3. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

4. *See, e.g.*, Larry Catá Backer, *The Sarbanes-Oxley Act: Federalizing Norms for Officer, Lawyer, and Accountant Behavior*, 76 ST. JOHN'S L. REV. 897, 905–11 (2002); Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REGULATION, Spring 2003, at 26; Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 81 (2005); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 IOWA J. CORP. L. 1, 57–59 (2002). *See also generally* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005) (arguing that Sarbanes-Oxley's corporate governance provisions should be optional rather than mandatory).

5. *See* Romano, *supra* note 2, at 392–97.

some ways rival, and possibly surpass, the competitive supply-side dynamics of the U.S. market for corporate law. In doing so, preemption facilitates an international system of corporate-law federalism that forces national regulators to internalize many of the costs of their decisionmaking.

This observation holds important implications for longstanding theories on the federal preemption of corporate law. Regulatory intervention by the federal government, though viewed as enabling regulatory monopoly, is largely modeled as the primary extrajurisdictional check to Delaware's power and as such opens up, from Delaware's perspective, "a two-front war" with states and national authorities. This Article demonstrates, however, that federal regulators, too, are engaged in a "doubled race." First, they must monitor for market failure and ensure that Delaware, the dominant supplier of corporate charters, provides sound corporate law. And second, they must themselves cope with the onslaught of competition from foreign national regulators seeking to attract securities transactions. As a result, preemption is likely a weaker counterweight to any regulatory competition arising among states than many scholars have anticipated.

To demonstrate, this Article is divided into four parts. Part II provides a brief overview of the conventional view of federalization. It shows how federal intervention has traditionally been associated with regulatory monopoly and how, as a result, the promulgation of corporate-law concerns through federal securities statutes has been criticized as eliminating beneficial regulatory competition.

The balance of the Article then moves to assess the competitive effects of preemptive securities regulation by examining the degree of competition occurring in the markets for corporate law and securities law. Part III focuses on the market for corporate law. It argues that conventional depictions of a market for corporate law are contradicted by the available data and recent interdisciplinary scholarship, which both demonstrate that growing monopoly power is held by one state—Delaware. The Article then builds on existing theories and offers new explanations for this development grounded in the demand- and supply-side dynamics driving the provision of corporate law by states.

Part IV undertakes a similar market-based assessment of the provision of securities law. Drawing upon recent empirical data, it demonstrates that no one nation dominates the market for global securities transactions. Instead, every country—even the United States—is actively vying to provide favorable securities laws in order to attract transactions. The

Article then provides new explanations for this competitive environment by identifying overlooked factors of supply and demand driving the market for securities laws and theorizing how fewer obstacles impede choice of law.

Finally, Part V draws on these insights to theorize the extent to which preemption encourages competition. It argues that although preemptive securities regulation removes the provision of law from the province of the states, federal regulators must still cope with an onslaught of competition from foreign national regulators. Responses to competition may, however, still allow for considerable systematic inefficiencies. Federal regulators may respond to competition by exempting foreign issuers. And because federal preemption in the United States involves the bundling of both securities and corporate law statutes, regulators may also choose not to reform unattractive corporate rules per se, but instead to make their securities regulations more competitive and thereby lower the net costs of issuer compliance. As a result, even though regulators may internalize the costs of promulgating unattractive corporate-law rules, such rules may nonetheless survive the crucible of international regulatory competition. Part V then ends by hypothesizing how, from an analytical perspective, a national incorporation statute may promote stronger federal power than preemptive securities regulations.

II. CONVENTIONAL VIEWS OF FEDERALIZATION

A. THE MECHANICS OF CORPORATE-LAW PREEMPTION

The provision of law regulating corporate activities in the United States has long been understood as functionally organized along state or federal levels of governmental authority. States, on the one hand, are viewed as the sources of substantive corporate law—that is, those rules governing the internal affairs of corporations and management's duties to shareholders.[6] Federal authorities, in contrast, are responsible for promulgating securities laws, those regulations governing the disclosure required by firms where they seek financing from capital markets.[7]

However, this oft-cited line of demarcation is not an established constitutional principle and indeed is not always honored.[8] Although the

6. Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 596 (2003) ("[S]tates govern internal corporate affairs . . . .").

7. *Id.* ("[F]ederal rulemakers, via the SEC, govern the external trading of the firm's securities.").

8. *Id.* at 597 (stating that "the internal affairs doctrine is just an understanding, not a crisp

federal government generally focuses on capital markets and corporate communications, it occasionally abandons tradition and provides independent, national rules regulating the internal affairs of firms. There are, for example, federal rules in place that govern the communications between shareholders when insurgent shareholders seek to acquire control of the company.[9] Federal rules also govern internal-affairs issues as diverse as mandatory disclosure rules by firms that allow shareholders to better monitor management, basic organizational matters concerning the internal controls of firms, and even whistleblowing procedures against corporate executives that breach their duties to shareholders.[10]

Yet perhaps surprisingly, these as well as all other substantive internal-affairs mandates are not promulgated through federal incorporation statutes—though at different times in U.S. history policymakers have advocated it.[11] Instead, the nationalization of corporate law usually occurs through the promulgation of federal *securities* legislation. Specifically, either Congress introduces corporate law legislation amending the Securities Act of 1933 ("Securities Act")[12] or the Exchange Act of 1934 ("Exchange Act"),[13] the two statutes constituting the architecture for U.S. securities regulation, or the Securities and Exchange Commission ("SEC") promulgates corporate-law mandates under its rulemaking authority. In both cases, companies must comply with the federal rules whenever they achieve a certain threshold shareholder base or where their shares are traded on a stock exchange.

constitutional rule," and highlighting Sarbanes-Oxley and securities-related disclosure requirements as examples of federal regulations of internal affairs).

9. *See, e.g.*, 17 C.F.R. §§ 240.14a-9, -101 (2007) (setting forth the information required in proxy materials).

10. *See, e.g.*, 15 U.S.C. § 78j-1(m)(4) (2006) (requiring audit committees to establish procedures for "the receipt, retention, and treatment of complaints . . . regarding accounting, internal accounting controls, or auditing" and for "the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters"); § 7264 (requiring issuers to disclose whether they have passed a code of ethics for senior financial management); § 7265 (mandating the SEC to promulgate rules requiring issuers to disclose whether a "financial expert" sits on its board's audit committee); 17 C.F.R. § 240.10A-3(b)(3) (setting forth whistleblowing procedures); § 244.100 (setting forth additional disclosure requirements for issuers employing non-GAAP financial measures); Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors, Securities Act Release No. 8340, Exchange Act Release No. 48,825, Investment Company Act Release No. 26,262, 68 Fed. Reg. 66,992 (Nov. 28, 2003) (setting forth disclosure requirements as to an issuer's nominating committee, the nominating process, and other related issues). *See also* Karmel, *supra* note 4, at 98–129 (discussing the regulatory changes made by the SEC in response to Sarbanes-Oxley).

11. *See infra* notes 18, 172–76 and accompanying text.

12. Securities Act of 1933, 15 U.S.C. §§ 77a–aa (2006).

13. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–nn (2006).

Several reasons likely explain why corporate law concerns are so frequently addressed by securities laws and regulations. First, and perhaps most obvious, the two fields have overlapping subject concerns. Both ultimately concern core matters of investor protection. Corporate law, on the one hand, largely addresses matters of internal governance and fiduciary responsibilities to shareholders, while securities laws address information required to be disclosed to shareholders (and indeed potential shareholders).[14] Thus, in regulating the former, governance of the latter may be affected. Disclosure statutes, for example, allow for efficient trading of securities.[15] At the same time, however, the regulation of the flow of information from the corporation to its shareholders comprises a core domain of a corporation's internal affairs.[16] Thus, in this regard, corporate governance is incidental to securities regulation.

Second, securities regulations offer a ready-made body of law for the regulation of firms. By using the available framework of the securities acts, legislators need not devise from the ground up a self-contained framework for a federal chartering system. Instead, the securities acts offer an inclusive system for regulating firms acting under federal authority. It is thus easier to add corporate law mandates incrementally to existing registration and disclosure requirements and thereby effectively coerce compliance indirectly by firms.[17]

Finally, although the regulation of corporate law by the federal

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14. *See, e.g.*, Karmel, *supra* note 4, at 82.

15. *See generally* John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984) (providing the four following claims in support of a mandatory disclosure system: (1) because securities research, as a public good, is usually underprovided, a mandatory disclosure system subsidizes search costs, which has the effect of increasing both the quantity and accuracy of information; (2) investors would otherwise incur excess social costs in pursuing trading gains; (3) the theory of self-induced disclosure is limited by its questionable assumption that manager and shareholder interests can be perfectly aligned; and (4) even in an efficient capital market, rational investors would still need the kind of information best provided through a mandatory disclosure system to optimize their portfolios); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999) (arguing that the mandatory disclosure system ensures a socially optimal level of disclosure that is unlikely to be attained under an issuer choice regime); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047 (1995) (proposing the reduction of agency costs as a superior efficiency justification for the rise of the mandatory disclosure system, although incompatible with the system's current focus on accuracy enhancement).

16. *See* Roe, *supra* note 6, at 611–12 (discussing the scope of SEC regulations over corporate affairs such as voting, proxies, and general disclosure).

17. *See* Sean J. Griffith & Myron T. Steele, *On Corporate Law Federalism: Threatening the Thaumatrope*, 61 BUS. LAW. 1, 5–6 (2005) (illustrating the incremental changes initiated by Congress through amendments to the existing securities laws or by the SEC through regulatory authority granted by the Exchange Act).

government is legal, it is not necessarily politically acceptable.[18] States have at least arguably done a good job of regulating some aspects of corporate governance.[19] And at least one state, Delaware, has made considerable investments in developing an architecture geared toward furthering corporate law in not only its legislature, but also its courts.[20] As a result, removing corporate law altogether from the province of the states would seriously undermine vested local interests in Delaware, as well as others that benefit from Delaware's system of governance.[21] These interests would, as a result, likely lobby their local representatives to thwart overt federal legislation. Intermittent, piecemeal securities regulation poses a less obvious threat than a national law requiring certain measures for charters. It also provides more political cover for U.S. rulemakers, given their traditional role as the national regulatory authorities of securities transactions.

B. PREEMPTION AND THE DEATH OF REGULATORY COMPETITION

Federalization does, however, generate controversy, especially among economists and legal academics. This is because where national authorities exercise power under the securities acts, their regulations, as operations of the federal government, necessarily have preemptive power over state law,

18. Indeed, federal incorporation has been attempted a number of times, with each attempt meeting with failure. *See, e.g.*, John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1752 (2007) ("Many of Roosevelt's corporate law advisors wanted to . . . enact a federal incorporation statute that would make Congress . . . the principal regulator of corporate law. But the campaign for federal incorporation foundered . . . ." (internal citation omitted)). *See also* Roe, *supra* note 6, at 600 (noting that there is currently no prospect for a federal incorporation statute).

19. *See, e.g.*, Jill E. Fisch, *The New Federal Regulation of Corporate Governance*, 28 HARV. J.L. & PUB. POL'Y 39, 48 (2004) (discussing the success Delaware courts had in developing the duty of good faith and takeover standards).

20. *See* Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 686 (2002) (stating that Delaware nearly stands alone in its legislative and judicial efforts to attract incorporations). *See also* Griffith & Steele, *supra* note 17, at 10 (noting that the Delaware Court of Chancery "can be thought of as an expert regulatory agency"); Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1385 (2000) (noting the efficiency of Delaware's laws and the experience of its judiciary).

21. Approximately 22 percent of Delaware's total revenues are derived from corporate chartering. DEL. DIV. OF CORPS., DEP'T OF STATE, 2007 ANNUAL REPORT 2 (2008), *available at* http://corp.delaware.gov/2007DivCorpAR.pdf. Indeed, "the raison d'etre behind [Delaware's corporate chartering] system has been [to raise] revenue for the state. " Cary, *supra* note 1, at 668. Just as much as Delaware benefits, so do nonstate actors. *See, e.g.*, *id.* ("Delaware corporate counsel take pride in their role and enjoy the fees that flow from it."); Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1774–76, 1783–86 (2006) (discussing the state's attempts to foster, rather than disrupt, preexisting commercial relationships based in Delaware).

to the extent that state law contradicts national mandates.[22]

Scholars consequently differentiate securities regulation from corporate-law federalism in terms of the degree to which competitive forces drive their development. Under corporate-law federalism, not only do states prescribe corporate-law rules, but firms are additionally free to choose their state of incorporation.[23] State corporate law is thus subject to competition insofar as states compete with one another for charters. If they do not compete, and fail to provide attractive corporate-law rules, they will lose incorporations to competitors.

Meanwhile, the securities regulations promulgated by the SEC and Congress are viewed as comprising a dramatically less competitive domain of regulation. In contrast to U.S. corporate law, where, scholars argue, federalism permits states to draw incorporations from other jurisdictions, national regulators enjoy a virtual monopoly over the provision of securities laws.[24] Their authority can instead generally only be thwarted, in the case of the SEC, by congressional action or federal judicial intervention or, in the case of Congress, by a Supreme Court ruling limiting the scope of the Commerce Clause. No rivalrous competition consequently characterizes the process in which securities laws are formulated.

The desirability of such competition has been a matter of long-held debate. On the one hand, some scholars, led perhaps most vociferously by Roberta Romano, argue that competition bolsters the quality of substantive

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22. Two forms of preemption are generally addressed in the literature: conflict preemption and field preemption. *E.g.*, JAMES T. O'REILLY, FEDERAL PREEMPTION OF STATE AND LOCAL LAW: LEGISLATION, REGULATION AND LITIGATION §§ 8.3–.4 (2006). Under conflict preemption, the state law is preempted insofar as it is inconsistent with the federal statute. *Id.* § 8.4.

Field preemption is, in contrast, analytically a more expansive form of preemption. Unlike conflict preemption, field preemption moves beyond the effects of state and federal law and examines whether state law conflicts with "the dominant federal interest, the expression of congressional purpose, and the pervasiveness of the federal regulatory system." *Id.* § 8.3. As a result, field preemption analysis hinges on whether the courts can determine if Congress has decided, expressly or impliedly, to exclude state regulation.

This article addresses both forms of preemption, and focuses on the "nationalization" of corporate law—not only, as Robert B. Ahdieh rightfully describes, "the imposition of regulation on a relatively de-regulated market," Robert B. Ahdieh, *From "Federalization" to "Mixed Governance" in Corporate Law: A Defense of Sarbanes-Oxley*, 53 BUFF. L. REV. 721, 742 (2005), but also the displacing of local regulatory markets by the federal government.

23. *See* Winter, *supra* note 1, at 252 ("[T]he decision as to which state to incorporate in is in almost all cases a managerial decision . . . not dictated by law or administrative decision.").

24. *See* Romano, *supra* note 1, at 2365 (stating that because federal securities laws apply to all publicly traded firms and states cannot lower the federal standards, "states have essentially abandoned the regulation of public firms to the SEC"). *Cf.* Tung, *supra* note 2, at 1379–80 (contrasting the competitive corporate charter model with the monopolistic securities regulation regime).

law insofar as it incentivizes states to consistently improve their laws and make them more useful to firms and their shareholders.[25] These scholars consequently view preemption, as well the existing framework for securities regulation, with much skepticism insofar as it inhibits local level experimentation.[26] Proponents of regulatory competition further argue that federal legislation creates paternalism costs because lawmakers may make mistakes and adopt inefficient rules that are never corrected due to the absence of an external market.[27]

At the same time, however, many scholars have long been skeptical of regulatory competition. For these scholars, competition incentivizes states to cater to managers seeking private benefits that may not enhance the welfare of investors or society.[28] As a result, many scholars view federalism as largely welfare diminishing, and instead have forwarded largely profederalization programs. Various centralization efforts have been espoused, including federal incorporation, robust defenses of the existing system of mandatory disclosure,[29] and predictions of an ever more powerful "strong-SEC" model of governance in which the regulatory agency would enjoy powers touching upon securities disclosure and, impliedly, corporate governance.[30]

C. THE LIMITS OF STRUCTURAL FORMALISM

As seen above, nationalization (and its preemptive effect) determines for most scholars whether competition in the markets for both securities and corporate law exists. That is, scholars focus almost exclusively on the specific level of rulemaking provided by the government and from it derive the degree of monopoly inhabiting a regulatory field. The higher (or more

25. Romano, *supra* note 2, at 392–93 ("[C]ompetition is desirable because it reduces the possibility that a regulator will be able to . . . redistribute wealth from the regulated sector to preferred individuals or organizations.").

26. *See infra* notes 34–36 and accompanying text.

27. *Cf.* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 574 (1990) (acknowledging that although state lawmakers may make legislative mistakes, "[c]orporate lawmaking by the states is not fiat but rather a dialogue between lawgivers and the corporate community," and emphasizing that "[c]ompanies have the final say in *that* dialogue because they can *re-incorporate elsewhere*") (emphases added)).

28. Perhaps the best-known advocate of this position is William Cary, who has articulated the foundational argument on the matter. *See* Cary, *supra* note 1.

29. *See* Mahoney, *supra* note 15, at 1111–12 (supporting mandatory disclosure systems as "the most cost-effective step . . . to combat the very large and persistent promoter problem").

30. *See* Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 799–832 (2006) (refuting competing regulatory theories that would place greater control in the hands of corporate managers in favor of a mandatory disclosure system as the most efficiency-enhancing regime).

national) the level of rulemaking, the more monopoly power is wielded by regulators.

Though useful in describing the impact of preemption on state-level rulemaking, this prevailing framework makes two important, albeit overlooked, assumptions. First, it at least implicitly holds that but for the preemptive effect of federalization, there exists a functioning economy for corporate law in which firms demand law and governmental authorities are incentivized to supply it. Second, in its emphasis on the displacement of state control through preemption, the dominant paradigm equates nationalization with unitary control.[31] In doing so, this view necessarily assumes that the only source of competition in markets for law arises from states. It is for this reason that, as a structural matter, securities laws are considered to be exposed to less competition than corporate law, since as a national form of regulation, regulators face no competition from alternative suppliers.

Each of these key assumptions deserves, however, closer scrutiny. Regulatory markets are no different from product markets insofar as both must be subject to the forces of supply and demand in order for competition to arise. On the demand side, both corporate law and securities law are products consumed by firms. As such, they must provide benefits that are attractive to firm decisionmakers. Meanwhile, on the supply side, no state can wield market power such that it unilaterally can set the price of regulation, states must be similarly incentivized to provide law, and there should be low exogenous and endogenous barriers to entry.[32] These are all context-dependent inquiries that must be assessed in light of the purpose and nature of the particular regulatory regime in question.

Similarly, preemption need not necessarily stymie all competition. To be sure, national regulation preempts state-level regulation. Economic theory has long suggested, however, that where consumers of law are mobile and the resources available in jurisdictions are comparable, those

31. *See* Roe, *supra* note 6, at 600 ("[T]he federal government can displace state corporate law, and rather easily. Legislation can preempt state corporate law, and it has."). *But see* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 3–4 (1993) ("[F]ederal regulations are mandatory. . . . [but] not preemptive . . . . [T]he federal securities regime establishes minimum disclosure requirements, which states can *expand* . . . ." (emphasis added)).

32. Yet even here, importantly, the competition engendered would have its limits. *See* William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 GEO. L.J. 201, 223–24 (1997) (perceptively noting that the bundling of public goods may be so diverse that only a republic with as many jurisdictions as people could ensure a perfect match between all of an individual's preferences and the services his or her jurisdiction provides).

consumers will migrate to those jurisdictions that provide regulations that are most consonant with their preferences.[33] As a result, even where rules are mandatory, regulators may not possess full control over the provision of law consumed by firms. Instead, the strength of a regulator's power will be based on the availability of other regulatory alternatives (and resources) in other jurisdictions. Where alternatives are available and mobility involves few transaction costs, firms will effectively enjoy choice of law.

In the context of the federalism debate, this means that where firms can tap international regulatory markets, national regulation may not necessarily effectuate monopoly power for national regulators. Although the formal level of regulation has clear implications for competition insofar as national preemption removes lawmaking from the province of the states, whether or not competition will be reduced entirely, or even at all, is a more complex inquiry.

These two observations suggest that a formalist approach to law will not, by itself, fully capture the factors of supply and demand that make possible a market for law. Instead, a closer examination of the microeconomic forces pushing for the provision of law is required. Law as a product must be assessed in light of the objectives of consumers (demand), and market forces informing competition must be identified and qualified in light of producers (supply). Only then can scholars determine with precision to what degree the preemption of traditional corporate-law concerns by securities legislation ("securities law preemption") obstructs or promotes regulatory competition.

Parts III and IV below thus undertake an economic and empirical analysis of the markets for both corporate and securities laws. In each section, the dominant view of the market for the particular legal domain is described in depth. Then, a brief survey of the empirical literature is made to defend the dominant view. Finally, a survey of the available literature is made to provide a qualitative explanation for an empirical snapshot.

33. *See generally* Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956) (arguing that consumers will move to the communities best representing their particular set of preferences, assuming, inter alia, they are fully mobile, informed, and faced with a variety of choices).

III. THE DOMESTIC MARKET FOR CORPORATE LAW

A. THE FEDERALIST ECONOMY OF SUPPLY AND DEMAND

Corporate-law federalism takes its cue from the general federalism literature and argues that localized structures of governmental authority activate a robust regulatory economy.[34] In particular, this dominant strain in the literature argues that competition arises from two structural features—decentralized authority vested in the states and mutual recognition by the states of one another's corporate laws. As to decentralized jurisdictional authority, scholars have argued that by devolving decisionmaking capacity from national authorities to the state, federalism creates a spectrum of "suppliers" of corporate law.[35] Instead of one provider of corporate law, as would presumably be the case if the national government wielded sole jurisdiction or preempted states from independent regulation, each of the fifty U.S. states can supply firms with laws governing the relationship between shareholders and management.[36]

Meanwhile, mutual recognition, the second important feature of corporate federalism, makes both demand- and supply-side competition possible. Corporate law, at least in an abstract sense, is inherently desired by firms because it offers opportunities of limited liability and allocation of resources unavailable under other organizational structures.[37] With mutual recognition, however, this theoretical demand is substantiated insofar as firms are not bound to operate under the rules of a particular jurisdiction. Instead, firms can incorporate in one state, say New Jersey, and operate out of another state like Nevada with minimal interference from regulators.

34. *See, e.g.*, Fischel, *supra* note 1, at 922 ("A scheme of regulation by fiat would replace a system of fifty states striving to create an attractive climate for private parties to maximize their joint welfare."); Winter, *supra* note 1, at 274–76 (arguing that competition among the states for corporate charters leads to a race to provide an "optimal return" for both management and shareholders).

35. *See* Tung, *supra* note 2, at 1380, 1385 (stating that the U.S. corporate-law model encourages competition among states to satisfy consumer preferences).

36. For those scholars supportive of federalism, such devolving allows those actors with the best information about local conditions and preferences to provide rules and regulations, as well as permitted local experimentation and innovation. *Cf.* ROMANO, *supra* note 31, at 5.

37. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 287–319 (1999) (discussing the relationships and benefits arising from the corporate structure, which includes, inter alia, the ability for shareholders to commit capital while yielding control to corporate directors). *See also* Margaret M. Blair, *The Neglected Benefits of the Corporate Form: Entity Status and the Separation of Asset Ownership from Control*, *in* CORPORATE GOVERNANCE AND FIRM ORGANIZATION: MICROFOUNDATIONS AND STRUCTURAL FORMS 45 (Anna Grandori ed., 2004) (presenting additional benefits of the corporate form such as preventing individual investors from unilaterally destroying the business entity).

Federalism thus gives consumers a "'pure' choice" as to a menu of legal public goods.[38]

These choices are all the more consequential, scholars have long held, since the ability of firms to choose (and, for that matter, leave) their states of incorporation incentivizes competition. Because firms that incorporate in a state pay incorporation fees, those states that successfully craft laws attracting incorporations will enjoy significant financial benefits, whereas less successful states will not.[39] Indeed, in the absence of either preemption or coordination by states, competition will force states to be responsive to the preferences of firms in order for them to preserve their markets and keep firms (and revenue) at home.[40] The implication is thus that although some states may be more successful than others at securing charters, the market for corporate law will be thick to the extent that *no* state will be able to afford to lose out on the tax revenues and fees that accompany incorporation.[41] Even successful players will face pressure to continually innovate.[42]

B. THE EMPIRICAL COUNTERARGUMENT

Because of the localized structures of corporate-law federalism, scholars have long assumed that the market for incorporations is robust, and have pointed to a range of earlier studies documenting "chartermongering" by states, particularly at the turn of the twentieth century.[43] Recent contemporary empirical evidence suggests, however, that

38. Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 574 (2002). Some scholars, however, have argued that even assuming firms are free to incorporate in any state, the choice is actually far more constricted in practice. *See* Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1569, 1572 (2002) (observing the trend that initial public offering incorporation choices from 1978 to 2002 revealed a bimodal incorporation choice: either Delaware or the firm's home state).

39. Romano, *supra* note 1, at 2373, 2388 (arguing that because firms will migrate to favorable regulatory regimes, states can increase their revenues by offering desirable regulations).

40. *See* Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 236 (1985) ("In a story of reactive responsiveness . . . most states respond to corporate desires in order to *maintain* their position, and not to enlarge their market shares." (emphasis added)).

41. *See* Fischel, *supra* note 1, at 922 (describing corporate federalism as a system "of *fifty* states striving to create an attractive climate for private parties to maximize their joint welfare" (emphasis added)). *Cf.* ROMANO, *supra* note 31, at 38 (remarking that "a state with a large proportion of its budget financed by the franchise tax will be responsive to firms, since it has so much to lose").

42. *See* ROMANO, *supra* note 31, at 5 (noting that "federalism spurs innovation in public policy because of the incremental experimentation afforded by fifty laboratories of states competing for citizens and firms").

43. *See, e.g.*, Christopher Grandy, *New Jersey Corporate Chartermongering, 1875–1929*, 49 J.

despite the structural features of federalism, the market for charters among states is currently devoid of broad competition. As has been noted by Lucian A. Bebchuk and Assaf Hamdani, 58 percent of U.S. public companies are incorporated in just one state—Delaware—along with 59 percent of Fortune 500 companies.[44] Furthermore, Delaware has acquired a dominant position in the market for charters from companies that choose to incorporate outside of their home states—nearly 85 percent of public companies incorporating outside of their home states do so in Delaware, along with 83 percent of Fortune 500 companies.[45] Indeed, no other state has a significant market presence. For example, Bebchuk and Hamdani noted that Delaware has captured a little over two hundred out-of-state incorporations of Fortune 500 companies, while no other state captured even ten, and the five states that followed Delaware's lead captured a total of twenty-five such out-of-state incorporations.[46] By any measure, such market share is considered to be very large and indicative of monopoly power.[47]

This trend shows few signs of abating. Indeed, the pattern of Delaware's share of corporate charters suggests that the state's virtual monopoly is only growing. In 1981, Delaware had secured only 29 percent of initial public offerings ("IPOs"),[48] which was itself a significant figure. By 2006, this number had risen to nearly 70 percent.[49] This data stands in stark contrast to the market share of Nevada, the state most cited as a possible competitor to Delaware in the future, whose market share has eroded from about 2 percent between 1986–1990 to 1.1 percent during 1996–2000.[50]

ECON. HIST. 677 (1989); William E. Kirk, III, *A Case Study in Legislative Opportunism: How Delaware Used the Federal-State System to Attain Corporate Pre-Eminence*, 10 J. CORP. L. 233 (1984); Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249 (1976).

44. Bebchuk & Hamdani, *supra* note 38, at 568.

45. *Id.* at 578.

46. *Id.* at 578 tbl.5.

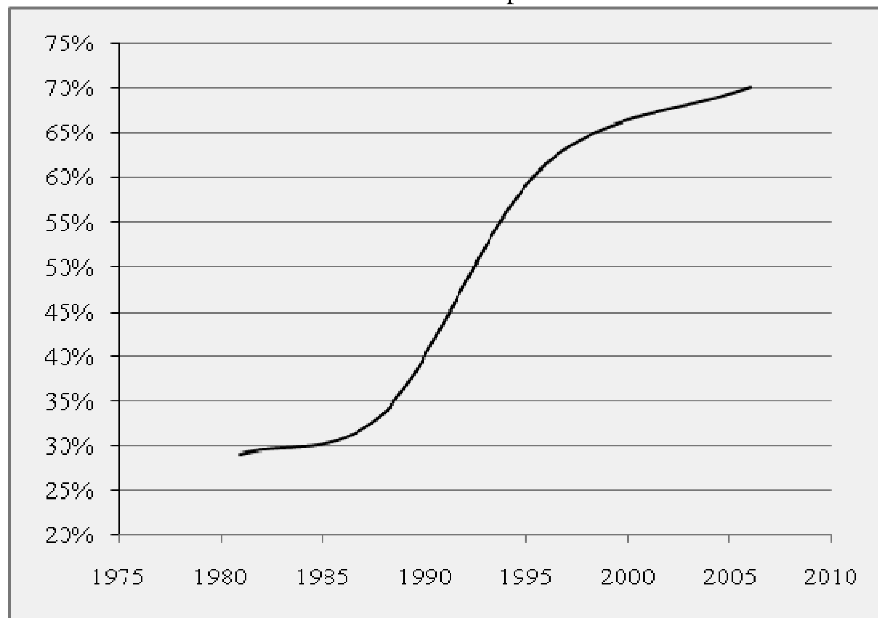
47. Indeed, Bebchuk and Hamdani have noted that, according to the Herfindahl index, a measure frequently employed by economists to measure market concentration, both the market for out-of-state incorporation and the market for Fortune 500 companies are nearly twice the level at which the government considers industries to be highly concentrated. *Id.* at 579.

48. Robert M. Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 538 (2001).

49. *See* DEL. DIV. OF CORPS., DEP'T OF STATE, 2006 ANNUAL REPORT 1 (2007), *available at* http://corp.delaware.gov/2006%20Annual%20Report%20with%20Signature%20_2_.pdf.

50. Kahan & Kamar, *supra* note 20, at 720.

FIGURE 1. Delaware's Share of U.S. Incorporations.



Although these figures do not speak directly to the competition arising where Delaware attempts to attract the business of firms weighing in-state incorporation, there are indications that, often, such home-state biases are unable to overcome the appeal of Delaware's corporate-law system.[51] This is because as a qualitative matter, relatively few attempts have been made by other states to replicate the sources of Delaware's dominance. Delaware's corporate-law system includes not only substantive corporate-law rules, but also an institutional infrastructure for applying and implementing those rules.[52] Perhaps most importantly, this infrastructure includes the Delaware Court of Chancery, a specialized and expert court for deciding complex matters of corporate law quickly.[53] The presence of this institutional infrastructure is, as other scholars have noted, a critical component of the quality of the system offered by Delaware.[54] A state looking to draw out-of-state incorporations will, as a result, have to heavily

51. For reasons as to why "local favoritism" might persist, see Bebchuk & Hamdi, *supra* note 38, at 573–74.

52. *Id.* at 580–81.

53. *Id.* at 580.

54. *Id.* at 580–81.

invest resources into developing such an institutional infrastructure.[55] Nevertheless, thus far no other state has made a serious effort to design its court system in a way that would be as attractive to corporations and challenge Delaware's dominance.[56]

These dynamics have led some scholars to conclude that state competition in corporate law is a "myth."[57] Scholars note that two critical aspects of competition—low market concentration and interstate rivalry—are largely absent in today's incorporation market. Although there might have been widespread competition in the past, available data suggests that the current market is not particularly rivalrous, especially when it comes to out-of-state incorporations.

C. MICROECONOMIC EXPLANATIONS FOR THE ABSENCE OF COMPETITION

Although no comprehensive theory has been proffered to explain the absence of a broad and vigorous corporate-law market, an examination of the outstanding literature suggests that Delaware's dominance can be explained by imperfect factors of supply and demand. As Part III.C.1 demonstrates, scholars have overlooked how, on the demand side, the enabling character of corporate law diminishes the demand for corporate law on the part of firms. Furthermore, as Part III.C.2 demonstrates, the relatively finite nature of the economic gains concomitant to incorporation, along with network effects enhancing the attractiveness of popular laws, diminish both the ability and incentives on the part of most states to enter into the incorporation market as suppliers.

1. The Demand-Side Problem of Enabling Corporate Law

Proponents of corporate-law federalism envision a regulatory economy in which managers demand favorable corporation laws and base their incorporation decisions on the attractiveness of laws supplied by a state's regulator concerning such issues. This view implies in part that a state's corporate law has important, substantive implications for firms and that the demand for corporate law is the product of a desire by firms to avoid unattractive rules that would impose costs on them or their management.[58] For this reason, the federalist paradigm contends that the

55. *Id.* at 581.

56. *Id.*

57. *See generally* Kahan & Kamar, *supra* note 20 (arguing that Delaware is the only state "engaged in significant efforts to attract incorporations of public companies").

58. *See generally* Cary, *supra* note 1, at 704 (favoring a federal interest in corporate conduct as much as in the market for its securities because "civilizing jurisprudence" should uplift standards, not

substantive quality of the corporate regime will figure centrally in the decisionmaking of management and thus drive the provision of corporate law.

Two strains in the literature, however, complicate these core descriptive assertions underlying the federalist account. First, many scholars contend that the structure of corporate law is largely "enabling" in character insofar as it is primarily composed of waivable default rules.[59] Second, scholars like Bernard Black have showed that even those rules that are not waivable are largely trivial.[60] Not only do many address circumstances that rarely materialize, but most that address more common circumstances would be universally adopted anyway, assuming people thought about them.[61]

Together, these arguments have important, albeit overlooked implications that reduce the prospects of a robust market for corporate law. To the extent to which corporate law is enabling or "fixable" by corporations through waivers or reincorporation, the importance of the initial choice of state is reduced. So long as transaction costs are relatively low, firms can incorporate in virtually any state and correct any default rules that are ill suited to the needs of promoters.[62] As a result, there should be relatively little demand for any specific set of corporate law so long as the corporate law provides core benefits to incorporated firms, such as limited liability.

allow them to deteriorate); Donald E. Schwartz, *A Case for Federal Chartering of Corporations*, 31 BUS. LAW. 1125, 1125 (1976) (favoring federal chartering in order to escape managers and directors finding the most permissive state law in which to incorporate and to "modernize the scope of the corporation's and management's goals beyond responsibility to shareholders").

59. *See generally, e.g.*, John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618 (1989) (suggesting that an active judiciary is necessary to counteract a regime of primarily contractual freedom); Elvin R. Latty, *Why are Business Corporate Laws Largely "Enabling"?*, 50 CORNELL L.Q. 599 (1965) (asserting that corporate laws are enabling in the sense that they are characterized by freedom of choice in determining allocation among the interested parties of risks, control, and profit).

60. Investors, as a result, can craft rules after the IPO stage that allow for the maximization of shareholder value. *See* Black, *supra* note 27, at 587 (remarking that the total one-time tax-deductible cost for reincorporation is about $40,000–$80,000 which, for a company of any size, is trivial, especially compared to the recurring average costs of $300,000 associated with printing and mailing annual reports).

61. Such rules include requirements like the majority-vote requirement to approve a charter amendment and the duty of loyalty. *Id.* at 552–54. This view also assumes that unattractive laws would undergo revision at the local level, *id.* at 554, although, as shall be shown below, this is not always the case.

62. *Id.* at 589.

2. The Supply-Side Problem of Asymmetric Incentives and Advantage

Recent economic theory further suggests that the supply-side dynamics for corporate law are highly imperfect. Not only do states have highly uneven incentives to compete, but significant externalities plague the market and dampen the attractiveness of many regulatory options. As a result, the market for corporate law is characterized by relatively little competition.

a. Asymmetric Supplier Incentives

Proponents of corporate-law federalism assume in large part that incorporation fees incentivize states to provide attractive laws for firm decisionmakers. Not all states have the same incentives, however. Incorporation fees offer tangible, albeit modest, economic benefits, with only several hundred million dollars of tax revenue generated annually in even the most successful state, Delaware.[63]

As a result, states with small revenue bases and economies will be more inclined to compete since the per-capita impact of attracting such fees will be larger.[64] The incentive structure suggests that although all fifty states can theoretically provide corporate law for firms, the universe of states actually incentivized to compete with others in doing so will be far fewer. Indeed, to the extent to which Delaware is the second smallest state in the United States and the forty-fifth most populous, few states, if any, will be as incentivized to compete for incorporations.

b. Legal-Network Effects

i. Interpretative-Network Externalities

There are also significant barriers to entry to the market for corporate law, especially where a jurisdiction becomes a popular place for incorporation. As more firms incorporate in a particular jurisdiction, the more likely it is that the relevant incorporation code will be litigated, and therefore, the more likely that future judicial interpretations will be provided.[65] In other words, the expected quantity and frequency of judicial interpretations is positively related to the number of firms that incorporate

63. Roe, *supra* note 6, at 594.

64. *See id.*

65. *See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 776 (1995) (noting that the more firms that have adopted a particular contract term, the more often such term is litigated, and thus, the more likely the contracts of all firms will use that term, resulting in network benefits).

in a jurisdiction.[66]

This is important because judicial interpretations usually reduce uncertainty for firms. Where courts intervene and decide disputes, they provide guidance as to the meaning of corporate-law terms and expectations.[67] Thus, by incorporating in a dominant jurisdiction—like Delaware—firms are able to free ride on the information produced by litigation taking place in Delaware's prominent chancery court.[68] As a result, an incorporating firm can reduce the costs associated with litigating ambiguous elements of the charter and is better able to avoid running afoul of the legal requirements imposed on firm actors. Interpretive networks thus reduce legal risk and confer benefits to participants unrelated to the substantive quality or attractiveness of a jurisdiction's code.

ii. Transaction-Execution Network Externalities

Network externalities also arise in the area of legal services. The more firms that have incorporated in a particular jurisdiction, the more legal-services professionals will be required to provide services such as drafting corporate documents like articles of incorporation and bylaws, interpreting a state's caselaw in order to advise clients regarding compliance, and litigating under the rules and laws of a regime if a dispute arises.[69] Over time, the fixed costs associated with these services will diminish as terms are litigated, refined, and made more concrete.[70] Furthermore, "the more often a lawyer performs services related to a particular [corporate law term or concept], the more efficiently he or she can repeat the task for other clients that use the same term."[71]

The speed at which these costs diminish will, however, depend in part on the number of participants that take part in any system. The more individuals that participate in a particular jurisdiction, the lower the pro rata cost of legal services will be.[72] Furthermore, as in the interpretive context, latecomers can free ride off the commoditized services that are available in popular jurisdictions. Consequently, there are cost savings associated with jurisdictional participation that accrue to popular jurisdictions and are unrelated to the substantive features of the jurisdiction's law. In a state like

66. *See id.*
67. *Id.* at 777.
68. *See id.*; Romano, *supra* note 40, at 280 (noting the benefits of precedent and certainty that the state of Delaware offers firms).
69. Klausner, *supra* note 65, at 782–83.
70. *Id.* at 783.
71. *Id.*
72. *See id.* at 784.

Delaware, the most popular of all states and one which exhibits a monopolist market concentration, these benefits may well be considerable.

iii. Structural Path Dependency and Risk Aversion

Finally, network externalities may also inform the cost of capital for firms. A company seeking to attract shareholders and bondholders offers such constituencies charter terms that they or their advisors must price. Utilization of infrequently used corporate law can have two consequences. First, where a firm adopts a unique or unusual term, "investors and analysts must adjust their pricing models . . . . [which] entails costs and uncertainty that at least some analysts will not find worthwhile, especially if the term involved will affect the firm's value in a way that is difficult to measure."[73] As a result, firms may suffer increased costs of capital due to diminished interest in their securities.

Second, the dominance of a regulatory market by one corporate-law regime may further play to cognitive biases among investors.[74] In short, the popularity of a corporate-law regime can create expectations in capital markets professionals that that regime will be followed insofar as venture capitalists may assume that such popularity translates into the "best" corporate law. Standard terms may "carry an aura of stability and objectivity."[75] Where they do, firms may be concerned that their securities will be negatively priced to the extent to which they depart from widespread norms, and as a result, may frequently choose a popular corporate-law regime though their own knowledge or experience suggests that they should do otherwise.[76]

D. IMPLICATIONS FOR COMPETITION

The imperfect demand- and supply-side dynamics informing the corporate-law market have significant implications for Delaware's market power. Asymmetric supplier incentives dwindle the supply of market suppliers, as do network externalities that project high barriers to entry.

73. *Id.* at 785.

74. Investors tend to view unusual terms skeptically, often as adverse information about the issuer, whether or not it actually is, which creates pressure towards uniformity. *Id.* (referencing underwriters' common advice that firms adopt familiar terms in their charters and indentures before issuing stocks or bonds to the public). *See also* Henry T. Greely, *Contracts as Commodities: The Influence of Secondary Purchasers on the Form of Contracts*, 42 VAND. L. REV. 133, 152–58 (1989) (discussing standardization in securities markets).

75. Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347, 363 (1996).

76. *See id.*

These dynamics imply that in today's corporate-law market, Delaware enjoys considerable market power—not only monopoly profits in terms of the "price" of regulation it charges firms,[77] but also a cushion (or as some scholars have conjectured, "slack") within which it can promulgate unattractive provisions without suffering a decrease in market share.[78] Consequently, although there is some disciplining of Delaware's conduct by the prospect of fewer potential market entrants where it abuses its power,[79] there is at least some opportunity for Delaware to offer suboptimal rules for shareholders in order to extract rents from firms or curry favor with firm decisionmakers.[80]

Some prominent scholars have even argued that any competition Delaware faces is the result of pressures not so much from other states, but instead from the federal government.[81] Among the fifty states, it is argued, Delaware has achieved a virtual monopolist position.[82] Not only does it enjoy tremendous (and growing) market domination, but it is also able to price the terms of regulations consumed by firms. However, where the federal government acts, it preempts all states, including Delaware, from promulgating their own laws. As a result, Delaware provides law in the shadow of the threat of federal intervention, and from this vantage point preemption serves as the primary discipline and motivation for efficient laws.[83] Yet even here, the federal government cannot and does not monitor all of Delaware's lawmaking. And for the legislative branch to act, failures by Delaware must often be so extraordinary so as to prompt actors to lobby their national government to change the rules. As a result, Delaware likely enjoys de facto liberty to construct and promote laws in ways free of vigorous competition.

IV. THE INTERNATIONAL MARKET FOR SECURITIES LAW

In contrast to the market for corporate law, the market for securities

77. *See* Kahan & Kamar, *supra* note 20, at 724 (noting that Delaware's franchise tax represent *supra*competitive returns, reflecting profit margins of several thousand percent).

78. Bebchuk & Hamdani, *supra* note 38, at 589–98.

79. *See id.* at 598.

80. *See id.* at 603.

81. Roe, *supra* note 6, at 591–92 (noting that Delaware's competition comes not from states, but from the federal government, and remarking that the federal system "can, and often does, take over economic issues of national importance," and could do so in the area of corporate law).

82. *See supra* Part III.B.

83. Roe, *supra* note 6, at 592 (expressing the view that there has never been, and never will be, a full state-to-state "race to the bottom" of corporate law since Delaware players know that the federal government can take away their corporate lawmaking power in whole or in part).

law has traditionally been characterized by scholars as beset by regulatory monopolies. This section draws upon the available empirical data to demonstrate that the dominant literature is again largely incorrect and that no country dominates the market for securities laws. It then employs network theory and a transaction-based view of securities regulation to explain why the field of securities regulation is more conducive to competition than the corporate-law context.

A. THE FEDERALIST PRESUMPTION OF REGULATORY MONOPOLY

1. The Problem of Territorial Capture

Scholars have traditionally conceptualized the market for securities laws as noncompetitive. Because securities laws are promulgated by national authorities, proponents of regulatory competition have taken their cue from the greater federalism literature and argued that regulators enjoy a monopoly over the provision of law.[84] Critics have, in particular, inveighed against the "territorial" or geographically based approach to jurisdiction exemplified in the Securities Act and the Exchange Act.[85] Under the Securities Act, all individuals seeking to sell stocks and bonds to the public in the United States who make use of "instruments of transportation or communication in interstate commerce" must comply with U.S. registration requirements.[86] The Exchange Act, meanwhile, focuses on secondary trading and imposes registration requirements on securities listed on a stock exchange located in the United States.[87] Thus, if a firm wishes to obtain financing by issuing securities that would be listed on any U.S. stock exchange, such as Nasdaq or the New York Stock Exchange, the firm

84. *See, e.g.*, ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION 3 (2002) (arguing that the current legislative agenda of de facto federal monopoly of securities law is inefficient and that the better approach would be a "market-oriented approach of competitive federalism that would expand, not reduce, the role of states in securities regulation," as "[u]nder such an approach, corporations would be able to select their securities regime from among those offered by states, the SEC, and even other nations, with the result that securities regulators would compete for firms' registrations"); Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998) (proposing a regime where an issuer of securities is allowed to choose the regime of securities regulation that will govern it, with all participating nations committing to respecting each firm's particular choice).

85. *But see* James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200 (1999) (questioning whether investors can efficiently price differences in regulatory regimes); Merritt B. Fox, *The Issuer Choice Debate*, 2 THEORETICAL INQUIRIES L. 563 (2001) (doubting that firm managers have the right incentives to choose optimal regulation regime).

86. 15 U.S.C. § 77e (2006).

87. LARRY D. SODERQUIST, UNDERSTANDING THE SECURITIES LAWS, § 9.4 (4th ed. 2005).

would become subject to U.S. securities laws. The Exchange Act further holds that any time a company has a substantial presence in the United States—when a company holds $10 million in U.S. assets and has over five hundred shareholders, three hundred of whom are in the United States—it generally becomes subject to federal reporting requirements.[88]

By attaching to both trading venues and shareholder bases, federal securities laws provide deep geographic coverage touching virtually all "transactions that occur within its borders, or that have substantial effects within its territory."[89] To conduct transactions in the United States or tap U.S. capital markets, issuers and investors must comply with the country's expansive securities laws and procedures. Even some extraterritorial transactions may be subject to U.S. laws where they touch or have a connection with the United States.

Many academics consequently argue that the territorial approach to regulation has enabled regulators, especially in the United States, to exercise de facto monopolies over the provision of securities laws in their jurisdiction.[90] Federal law touches virtually all transactions in the country, and its preemptive effect usurps state authority over key elements of the internal affairs of firms, such as corporate governance. And because U.S. markets have traditionally been the largest and most liquid in the world—and thereby have provided more capital and returns to scale[91]—most multinational companies have been obliged to come to the United States for financing and in the process subject themselves to U.S. laws.

2. Network Externalities Redux

The law and finance literature, though never directly applied to the securities-law context, further implies that even if securities regulations did not have comprehensive coverage, the market for securities laws would likely still exhibit weak competitive dynamics. This is because securities laws, like corporate laws, consist of terms that are explained and clarified over time. Once new rules and regulations are adopted and promulgated by legislatures or administrative bodies, they are often interpreted by courts or

88. *Compare id.* (noting the $10 million in assets and five hundred shareholder threshold), *with* 17 C.F.R. § 240.12g(3)-2 (2007) (creating an exemption for foreign private issuers with less than three hundred U.S.-resident shareholders).

89. Tung, *supra* note 2, at 1371.

90. *See* Romano, *supra* note 1, at 2365 (noting that the territorial approach, which prohibits states from lowering or raising the regulatory standard, has resulted in states abandoning any attempt to regulate securities even though they are not preempted from doing so by federal law).

91. *See* Robert B. Ahdieh, *Making Markets: Network Effects and the Role of Law in the Creation of Strong Securities Markets*, 76 S. CAL. L. REV. 277, 280 (2003).

in administrative proceedings. Legal-services professionals must also prepare documentation related to compliance, such as financial statements and offering memorandums, and be prepared to defend companies from private lawsuits and investigatory procedures initiated by regulators.

As in the corporate-law context, these activities often entail economies of scale and scope. The more often a lawyer performs services related to a particular provision of a securities code or regulation, such as shelf takedowns or 144A prospectus drafting, the more efficiently the lawyer can repeat the task for other clients with similar needs.[92] As a result, the fixed costs and marginal costs of tailoring advice or documentation for a specific task decline as a lawyer acquires expertise.[93]

This line of economic theory consequently predicts that, as in the corporate-law context, frequently used jurisdictions develop network effects that help to lock in participants and incentivize continued use. Well-known or highly utilized jurisdictions develop clarity for users, a particularly strong concern given the potential penalties firms can incur if they fail to comply with some countries' disclosure and corporate-governance requirements. Furthermore, lawyers in these jurisdictions develop easily commoditized expertise that lowers the marginal cost of the provision of their services.

B. THE EMPIRICAL COUNTERARGUMENT

For nearly fifty years, the United States has been home to the most liquid capital markets in the world and, as a result, has dominated the market for not only securities transactions, but also, by extension through territorial governance, securities laws.[94] As a result, the presumption of a U.S. regulatory monopoly has had considerable theoretical purchase and

92. *See* Klausner, *supra* note 65, at 783.

93. *Id.*

94. *See, e.g.*, ERNST & YOUNG, GLOBALIZATION: GLOBAL IPO TRENDS REPORT 2007, at 16 (2007), *available at* http://www.ey.com/Global/assets.nsf/International/SGM_IPO_Trends2007/$file/Global_IPO_Trends_2007.pdf ("New York, during the last century at least, was regarded as the center of the financial world."). For example, in the years following World War II, New York outpaced London in the number of international issues by nearly four to one. YOUSSEF CASSIS, CAPITALS OF CAPITAL: A HISTORY OF INTERNATIONAL FINANCIAL CENTRES, 1780–2005, at 207 (Jacqueline Collier trans., 2006). The success of the U.S. market continued, though at times unevenly, up through the 1990s, a boom-time for international listings, with "the number of foreign companies listed on the NYSE increas[ing] from 100 to almost 400." Luigi Zingales, *Is the U.S. Capital Market Losing Its Competitive Edge?* 2 (ECGI Working Paper Series in Finance, Working Paper No. 192/2007, 2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1028701 ("NASDAQ enjoyed similar fortune, while the European exchanges, including London, lost market share.").

consistently has informed theoretical discussions of capital-markets regulation (and deregulation).

Recent empirical evidence suggests, however, that in the last decade, as markets have globalized and as capital has become more widely dispersed, "U.S. exchanges are competing with other world exchanges like never before."[95] As measured by the ability of the U.S. market to attract listings of foreign companies engaged in IPOs on an exchange outside their respective countries of domicile—so called global IPOs—the U.S. has experienced a dramatic decline in its market share from 44.5 percent in 1996 to just 10.1 percent in the first nine months of 2007.[96] The United States has also experienced a decline in global IPOs in terms of value, as its share has declined from 58.8 percent in 1996 to just 7.7 percent through the first nine months of 2007.[97] And in 2007, none of the twenty largest global IPOs were done in the United States.[98] Meanwhile, foreign exchanges have increasingly attempted to attract not only foreign listings, but also U.S.-domiciled companies.[99] In this respect, the London Stock Exchange's AIM market has been particularly successful, attracting thirty-seven U.S. companies that have bypassed listing domestically since 2002.[100]

95. ERNST & YOUNG, *supra* note 94, at 8.

96. COMMITTEE ON CAPITAL MARKETS REGULATION, THE COMPETITIVE POSITION OF THE U.S. PUBLIC EQUITY MARKET 1 (2007), http://www.capmktsreg.org/pdfs/The_Competitive_Position_of_the_US_Public_Equity_Market.pdf.

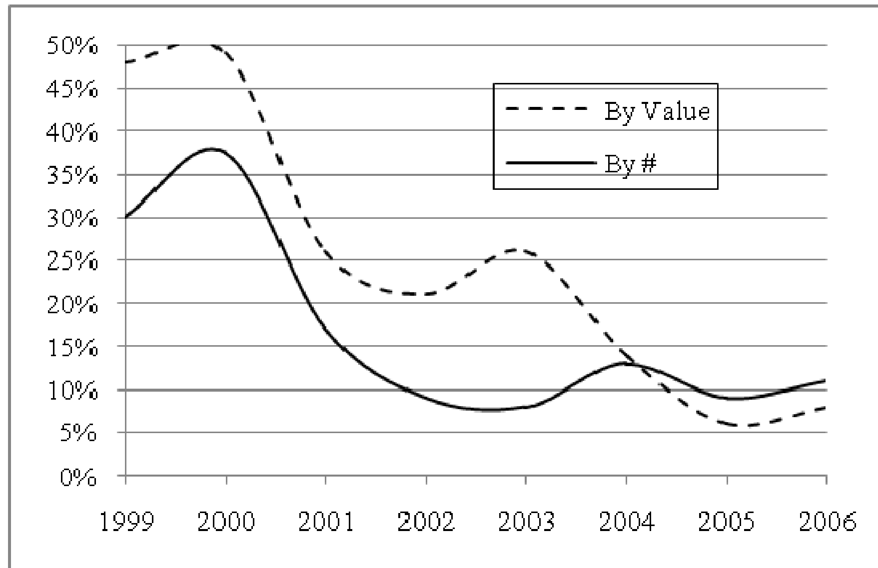
97. *Id.* at 1–2.

98. *Id.* at 2.

99. *Id.* at 16.

100. Thomas Frostberg, *AIM Grabbing Nasdaq Business: U.S. Companies Find New Investors on London Market*, S.F. CHRON., Apr. 28, 2006, at D1.

FIGURE 2. Share of Global IPOs Captured by the United States.[101]



This data becomes all the more salient when one takes into account a simultaneous decline in cross-listings in the United States. Even companies that do IPOs abroad may still cross-list their securities and in the process become subject to the country's reporting requirements and antifraud regimes. As a result, even where the United States does not capture IPOs, it could possibly capture securities transactions through secondary trading. Available data suggests, however, that foreign markets have not only been more successful in attracting IPOs, but have also kept cross-listings from migrating to the United States.[102] The share of U.S. cross-listings since 2000, for example, has declined dramatically.[103] Only twelve new cross-listings were transacted on the major U.S. exchanges in 2003, "the lowest number of new cross-listings since 1989."[104] Furthermore, in 2004 and 2005, new Level II and Level III ADR cross-listings were at their lowest level since 1992.[105] This trend, along with the overall decline in the United States's global share of IPOs, strongly suggests a decline in both the U.S. share of securities transactions and, by extension, its market power as a

101. COMMITTEE ON CAPITAL MARKETS REGULATION, *supra* note 96, at 11 tbl.5.

102. *See* Zingales, *supra* note 94, at 14.

103. Hong Zhu & Ken Small, *Has Sarbanes-Oxley Led to a Chilling in the U.S. Cross-Listing Market?*, CPA J., Mar. 2007, at 32, 32, *available at* http://www.nysscpa.org/cpajournal/2007/307/essentials/p32.htm.

104. *Id.* at 36.

105. *Id.*

provider of securities laws.[106]

Even U.S. issuers have increasingly sought to tap foreign markets. Although most large companies are subject to U.S. securities regulation due to their presence in the United States and thus are ensnared by the territorial approach employed by U.S. regulators, small companies and start-ups are not. As a result, these companies have, with greater frequency, migrated to other countries for financing, especially, as noted above, to the United Kingdom.[107] Such migration possibly allows firms to lower insurance, indemnity and issuance costs, as well as the costs of maintaining a market quotation.[108]

The success of foreign markets has spurred U.S. regulators more than at any time in the past to make U.S. securities laws more competitive. Because legal costs figure heavily in the decisionmaking of firms deciding where to list, a variety of domestic interest groups have pressured both the SEC and Congress to provide more attractive rules for issuers, especially in the aftermath of Sarbanes-Oxley.[109] In the wake of such pressures, regulators have initiated a variety of reforms, including a highly publicized "war against complexity," which aims to rationalize issuer disclosure rules and corporate governance, as well as to reconcile U.S. accounting rules with other international standards.[110] Officials have also instituted reforms aimed at curbing class action litigation, and thereby the legal risks accompanying U.S. issuances.[111] Meanwhile, foreign regimes also seeking to draw securities transactions to their borders have sought to cherry-pick the most attractive elements of U.S. law in order to promote their domestic financial centers.[112]

106. *See* Zingales, *supra* note 94, at 19–20.

107. *See* Frostberg, *supra* note 100.

108. Martin Waller, *U.S. Companies Turn to AIM for Growth*, TIMES (London), Nov. 14, 2005, at 45.

109. Chris Brummer, *Stock Exchanges and the New Markets for Securities Laws*, 75 U. CHI. L. REV. (forthcoming 2008) (manuscript at 37–40, on file with author).

110. Rebecca Knight, *SEC Fights Financial Gobbledygook*, FIN. TIMES (London), May 11, 2007, at 9; Press Release, Sec. Exch. Comm'n, SEC Votes to Modernize Disclosure Requirements to Help U.S. Investors in Foreign Companies (Aug. 27, 2008), *available at* http://www.sec.gov/news/press/2008/2008-183.htm.

111. *See* Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (codified as amended in scattered sections of 28 U.S.C.). *See also* Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.); Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C. § 1964).

112. The Tokyo Stock Exchange, for example, is considering greater use of English and the creation of U.S.-styled trading instruments for foreign issuers. Sundeep Tucker, *Tokyo Faces an Uphill Battle in Attracting Foreign Listings*, FIN. TIMES (London), June 28, 2007, at 38.

C. Microeconomic Explanations for Regulatory Competition

The diminishing competitiveness of U.S. capital markets by definition contradicts longstanding presumptions of regulatory monopoly associated with securities regulation. Not only does it imply vigorous competition in the market for securities transactions, but it also, by extension, denotes competition among regulators and a burgeoning market for securities laws. This part provides new explanations for this competition. Part IV.C.1 shows how the demand-side dynamics driving this competition can be explained by the nonwaivable character of securities regulation that generates strong demand for attractive securities regulation. Meanwhile, as Part IV.C.2 shows, low supply-side barriers of entry due to technology and limited network externalities make competition among jurisdictions possible.

1. Mandatory Regulation and the Demand for Corporate Law

As mandatory regulations, securities laws have demand-side implications that are far less ambiguous than those of corporate laws. Because they are nonwaivable, firms must carefully choose where to list their securities. They will not be able to tailor securities laws to their individual preferences. Also, once firms become subject to a particular country's rules, it has historically been difficult—especially in the United States—for many companies to disentangle themselves from that country's jurisdiction due to their large domestic shareholder base.[113] As a result, managers of issuers are incentivized to compare and evaluate carefully the costs and benefits of each country's regulatory regime, as some regimes may allow firms to signal credibility, and in doing so impose fewer transaction costs.[114] The mandatory nature of securities laws consequently creates greater demand and heightened interest in the value proffered under different regimes.

2. Consumer Mobility and Choice

There are also powerful supply-side dynamics undergirding the

113. *See* Sarah Murphy & Virginia Flower, *SEC Deregistration: The Solution for Non-U.S. Companies*, PLC MAGAZINE, May 2007, *available at* http://plc.practicallaw.com/2-313-0998.

114. For a sample of the literature on the assessment of the potential costs and benefits of regulation, see John C. Coffee, Jr., *Racing Towards the Top? The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002) (arguing that strong securities laws attract firms); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997) (finding that legal environments that protect financiers from exploitation by entrepreneurs results in expanded equity markets).

market for securities law, a fact highlighted in recent finance theory and legal scholarship.[115] Although securities laws have deep geographic coverage, advances in communications technology have made both issuers and investors more mobile than ever. Where in the past, investor orders for overseas securities would take hours, days, or even weeks to conclude, innovations like the internet have made the execution of orders possible in a matter of milliseconds, thereby dramatically increasing the likelihood of successful order execution.[116] This advancement has, among other things, heightened the attractiveness of non-U.S. exchanges for foreign firms seeking to list their securities.[117]

Technological advances also have lowered the barriers of entry to the exchange services business, and, in the process, have increased the number of venues open to investors. Whereas not so long ago a major exchange would have to purchase an acre of land, construct a trading floor, and employ a bank of telephones just to conduct a transaction, trading now can be executed via computers and trading screens located in any number of broker-dealers' offices.[118] Trading technology is also increasingly commercially available to stock markets everywhere, "making it possible for even the youngest exchanges . . . to make the technical aspects of their operations first-class."[119] Upstart foreign exchanges as a result have been able to attract more issuers with fewer costs and across national boundaries. This democratization of capital has reduced the traditional dominance of U.S. regulators, who in the past wielded default influence due to the dominance of their domestic exchanges.[120]

Together, these developments have led to more competition between regulators.[121] Although U.S. exchanges are still the largest in the world, the growing liquidity of non-U.S. venues has meant that it is no longer an economic imperative that foreign firms tap U.S. capital markets.[122] Furthermore, the mobility enabled by information technology has allowed

115. *See, e.g.*, Brummer, *supra* note 109; Joseph A. Grundfest, *Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences*, 4 J. FIN. SERVICES RES. 349, 361–62 (1990).

116. *See* Grundfest, *supra* note 115, at 361–62.

117. Brummer, *supra* note 109 (manuscript at 26–34).

118. Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31, 33–34 (2007).

119. *Id.* at 34.

120. *See* ERNST & YOUNG, *supra* note 94, at 14 (noting that, in contrast to the past, where "big global companies . . . were compelled to have [NYSE] listings as part of their offerings," now "the increased liquidity" of foreign markets has "made the US market . . . less competitive").

121. *See* Brummer, *supra* note 109 (manuscript at 40–41).

122. *See id.* (manuscript at 36).

issuers and capital to move across borders easily and cheaply.[123] As a result, foreign issuers are better positioned than ever to raise capital anywhere in the world.[124]

3. Supply-Side Incentives

a. The Value of Securities Transactions

Federal government officials likely are more incentivized to compete than their state counterparts in the corporate-law context. Securities transactions are more than a matter of national pride—they create jobs that potentially drive both local and national economies.[125] In the United States, for example, the financial-services industry directly accounts for one in every nineteen jobs.[126] And in New York City, the country's largest financial center, financial-services employment represents one in every nine private sector jobs.[127]

These jobs are in turn a source of economic growth and tax revenues for municipal and national governments. They also, not surprisingly, activate a variety of powerful interest groups poised to benefit immensely from attractive securities regulation, particularly in an environment in which domestic markets face stiff competition from foreign exchanges.[128] To the extent that securities transactions migrate overseas, investment bankers, lawyers, accountants, and of course stock exchanges themselves lose the income related to executing corporate deals (as well as their very jobs). As a result, these groups have mobilized forcefully and consistently to lobby both Congress and the SEC for rules that help make U.S. securities markets more attractive.[129] This lobbying provides strong incentives for lawmakers to compete in the provision of securities laws and helps to explain recent initiatives to rationalize U.S. securities law regulation.[130]

123. *See* Tafara & Peterson, *supra* note 118, at 34.

124. *See* ERNST & YOUNG, *supra* note 94, at 14.

125. MCKINSEY & CO., SUSTAINING NEW YORK'S AND THE U.S.' GLOBAL FINANCIAL SERVICES LEADERSHIP 7 (2007), http://www.nyc.gov/html/om/pdf/ny_report_final.pdf.

126. *Id.* at 10.

127. *Id.* New York is not the only city dependent on financial-securities transactions. Other U.S. cities heavily reliant on financial services include Hartford (one in every eight private sector jobs), Charlotte (one in twelve), Boston (one in fourteen), San Francisco (one in fourteen), and Miami (one in eighteen). *Id.* at 36.

128. *See* Brummer, *supra* note 109 (manuscript at 37–40).

129. *Id.*

130. *Id.*

b. The Limited Nature of Legal-Network Externalities

There are also few network-related barriers to entry in the market for securities law. In contrast to the corporate-law context, where competitors (U.S. states) share common norms and institutional backdrops, countries frequently exhibit wide variance in terms of their legal regimes. As a result, the rules propagated in less conventional jurisdictions may be embedded in larger systems that exhibit clarity, provide cheaper legal services, and offer lower costs of capital in ways that neutralize the advantages of legal networks and in the process enable competition with even the most popular regimes.

i. Interpretative Networks

Network theory predicts that interpretative networks are generated as litigation in popular regimes creates benefits with regard to the clarity of a jurisdiction's legal rules and that firms then are attracted to these jurisdictions insofar as they can free ride on such clarity.[131] In making these claims, this view necessarily presumes that similar (and significant) legal risks are tied to litigation in each jurisdiction and that it is this legal risk that effectively makes possible supply-side externalities as litigation arises in popular jurisdictions.

These presumptions are correct in the corporate-law context to the extent that all of the U.S. states share roughly similar legal features and risks. Corporate codes are supplied by state legislatures, and where state law is violated, litigation is commenced by or on behalf of shareholders using the same basic means—derivative suits or class actions. This litigation, though potentially exposing parties to significant legal risks, creates clarity to the extent to which firm stakeholders can depend on judgments by courts to provide clarity for future conduct.

Countries, however, vary much more as to the degree of legal risk accompanying securities transactions within their borders. In the United States, litigation is relied upon as a form of regulation[132]—that is, litigation not only is expected, but also is encouraged through instruments like class action devices to deter fraud and supplement governmental agencies tasked with regulating issuers. On the other hand, most other countries do not have such aggregation technologies and similarly litigious cultures.[133]

131. *See supra* Part III.C.2.b.i.

132. ERNST & YOUNG, *supra* note 94, at 14.

133. Only in Europe have advances been made that have begun to embrace aggregate litigation in the field of securities litigation. *See* Richard A. Nagareda, *Aggregate Litigation Across the Atlantic and the Future of American Exceptionalism*, 62 VAND. L. REV. (forthcoming 2009), *available at*

Regulators also differ greatly as to their regulatory philosophies. Regulators like the SEC engage in so-called "rules-based" regulation in which regulators prescribe a set of rules and then intervene *post hoc* where those rules are violated. Other regulators, meanwhile, have adopted "principles-based" regulation whereby firms are allowed to decide how best to achieve required outcomes, allowing for a much greater alignment of regulation with business practice.[134] Thus, under this approach, lawmakers are generally more inclined to offer guidance, rather than fines, to firms in situations of noncompliance with such standards. As a result, whereas the SEC in 2007 issued civil fines 655 times, principles-based U.K. regulators assessed only 125 civil penalties.[135] The size of civil penalties can also differ dramatically. Whereas there are no restrictions on the SEC's ability to impose civil fines, regulators in Japan are constrained by statute to assessing a maximum sanction of no more than $5 million.[136]

This variance has important implications for interpretative-network externalities. Interpretative networks create value insofar as they reduce the likelihood of future litigation by providing clarity. Where, however, there is little legal risk ex ante in a jurisdiction, interpretative networks generate few advantages: firms already enjoy relatively little legal risk. As a result, many jurisdictions exhibit institutional or legal features that reduce the cost of capital for firms independent of becoming popular locales of litigation. Interpretative-network externalities have, as a result, a lower impact.

ii. Legal-Services Externalities

The deep contextual heterogeneity of national securities laws also has important implications for legal-services externalities. Legal-services externalities are presumed to lower the cost of capital by reducing the cost of legal services as lawyers master tasks tied to litigating disputes or

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1114858. Yet, the U.S. model remains by far the most advanced and most comprehensive. *Id.*

134. Roel C. Campos, Comm'r, Sec. Exch. Comm'n, Remarks Before the Governance for Owners Conference (Mar. 22, 2007), *available at* http://www.sec.gov/news/speech/2007/spch032207rcc.htm. Such distinctions, however, are very crude, as most regulatory systems utilize a mix of both rules and principles. Lawrence A. Cunningham, *A Prescription to Retire the Rhetoric of "Principles-Based Systems" in Corporate Law, Securities Regulation, and Accounting*, 60 VAND. L. REV. 1411, 1412–13 (2007). *See also* Paul A. Merolla, *Principles-Based Versus Rules-Based: What Really Matters*, INVESTMENTNEWS, Nov. 19, 2007, at 10, *available at* http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20071119/REG/711190301/1011d (discusssing the merits of the two approaches and advocating for greater focus on the outcomes of each regulatory regime).

135. Stephen Joyce, *Global Regulators Disagree on Effective Enforcement Tools, Practices*, [Jan.–June] Sec. Reg. & L. Rep. (BNA), at 191, 191 (Feb. 11, 2008).

136. *Id.*

executing transactions.[137]

Not all jurisdictions, however, entail the same up-front legal costs. Some countries have rules that require labor-intensive involvement by lawyers in such activities as due diligence and document review, whereas others do not.[138] Furthermore, lawyers command vastly different fees in different countries.[139] As a result, less popular jurisdictions may still enjoy lower costs of capital than popular ones benefitting from network advantages. Low levels of legal risk may reduce the need for vigorous and costly legal services. If material misstatements or omissions in a prospectus are unlikely to expose a company to stiff civil suits or criminal sanctions, there is less need for legal services. Legal-services externalities may thus have a small impact on firm listing decisions in many circumstances, thereby diminishing the advantages of popular or traditionally dominant jurisdictions.

iii. Marketing Externalities

Of all network-related externalities, marketing externalities are those most likely to have implications in securities regulation. As in the corporate law context, a firm seeking to attract shareholders in a public offering will comply with various degrees of disclosure and corporate governance that the shareholders or their advisers must analyze and price. And certainly, "[t]he cost and reliability of analyzing and pricing these terms may be affected by their similarity to the terms that other firms use. If a firm employs commonly used terms, investors and securities analysts can use routine financial analysis to estimate the value of its securities."[140]

Still, there are several good reasons to believe that the significance of these network effects in the securities law context may be modest. As a practical matter, because many, if not most, securities regulations relate to

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137. *See supra* Part III.C.2.b.ii.

138. In the United States, for example, due diligence is a high fee-earning activity for firms, insofar as it provides market intermediaries and firm management with a defense against civil litigation under Section 11 of the 1933 Exchange Act. *See* William K. Sjostrom, Jr., *The Due Diligence Defense Under Section 11 of the Securities Act of 1933*, 44 BRANDEIS L.J. 549, 549 (2006). Section 12(a)(2) has a similar, though less demanding requirement. *See* 15 U.S.C. § 77k (2006). In other countries, however, due diligence remains a foreign concept.

139. Among financial centers, these differences can be stark. First-year New York attorneys at top firms earn, on average, $160,000 a year plus bonuses, approximately 25 percent more than their nearest competitors, those lawyers practicing in London's Magic Circle firms. *See Magic Circle Duo Follows Wall Street to Match $160K Pay Benchmark*, LEGAL WEEK, Jan. 2, 2007, http://www.legalweek.com/Articles/1004621/Magic+circle+duo+follows+Wall+Street+lead+to+match+160k+pay.html.

140. Klausner, *supra* note 65, at 785.

disclosure, securities law terms are rarely "unique." Instead, regulators differ from one another in terms of the degree of disclosure or the penalties of nondisclosure.[141] Thus, the crux of regulatory difference is not so much the substantive disclosure rule, but instead how much has to be disclosed. These differences, or lack thereof, will likely be easy for securities analysts to analyze and price.

Furthermore, even where securities laws may incorporate new substantive terms, pricing, as with most other transactions, is determined by intermediaries, thereby cutting the costs of learning about the merits of different jurisdictions. Although smaller investors may not find it worthwhile to employ such intermediaries, institutional investors do, and in the process of using this information, they proliferate information regarding these markets.[142] Countries adopting new substantive regimes also can, and do, adopt regimes that are incrementally different from major jurisdictions in clear ways that are easy to understand, reducing the costs of learning about the new regime.[143]

D. IMPLICATIONS FOR COMPETITION

These structural features suggest that national securities regulators enjoy little slack with regard to the regulation of foreign issuers. Technology has increased mobility and choice among foreign issuers and U.S. start-ups, and the diverse heterogeneity of jurisdictions has minimized legal-network externalities. As a result, even the traditionally dominant U.S. regulators can ill afford to promulgate broad and unattractive securities laws for increasingly mobile issuer constituencies, for the promulgation of such rules would trigger losses in the United States's global market share of securities listings as issuers and transactions would just migrate to other jurisdictions.[144]

In this way, U.S. securities regulators no longer possess a monopoly over the regulation of securities laws. Though some issuers may be subject to registration, foreign issuers are not, and the intermediation of domestic corporate law into the securities field can affect the number of offerings in the United States. To the extent powerful domestic interests are affected by this dynamic, they will lobby lawmakers to make U.S. laws more attractive,

141. Some regulators, for example, may require disclosure of executive compensation and related-party transactions where others do not.

142. *See* Choi & Guzman, *supra* note 84, at 934.

143. *Id.* at 934–35.

144. Indeed, even larger companies could conceivably attempt to buy back shares and relist them on foreign markets, effectively facilitating their departure from a jurisdiction.

causing regulators to internalize the costs of their decisionmaking.

V. REASSESSING THE IMPACT OF PREEMPTIVE SECURITIES REGULATION

A. PREEMPTION AND THE PROSPECT OF INTERNATIONAL FEDERALISM

The very different features informing the markets for corporate law and securities law compel a reconsideration of prevailing economic theories of preemption. When compared, the international market for securities transactions appears to be—in contradiction to the dominant descriptive literature—animated in some ways by *more* competition than the domestic market for corporate law, not less. In the market for corporate charters, Delaware enjoys a dominant position, and barriers to entry and other structural features suggest that other states are insufficiently equipped and poorly incentivized to challenge Delaware's lead. Meanwhile, in the market for securities transactions, there is much less dominance by any one jurisdiction, a thicker market of active competitors, and fewer barriers to entry and network externalities.

It is important to emphasize, however, that the existence of a thinner regulatory market does not necessarily mean that domestic corporate law is plagued by rules inefficiency. As alluded to above, it is plausible that Delaware, despite the absence of broad regulatory competition, is constrained in terms of the public law it promotes. Bad or poor regulatory decisions may spark greater home-state incorporations, new entrants into the market, or federal intervention.[145] Existing rules thus may reflect a fairly efficient equilibrium where Delaware provides law at a marginal profit low enough to disincentivize market entry by potential competitors.

What is clear, however, is that the market for securities laws exhibits features that in many ways rival—and possibly surpass—certain features of the market for corporate law. Where corporate law is passed by federal regulators under securities statutes and regulations, it is not so much usurped by a national monopolist, but instead enters a system of regulatory competition animated by foreign national regulators seeking to both attract and retain securities transactions. Such a decentralized "international federalism" has many of the signposts of domestic state-level competition. Although interest group politics diverge across lawmakers,[146] national

145. *See supra* notes 79, 81-82 and accompanying text.

146. For example, some countries have different private constituencies wielding different forms and degrees of influence over national regulators.

governments—as opposed to local or provincial bodies—act as suppliers of rules, incentivized either through tax revenue generated by employment or domestic interests to compete.[147] Meanwhile, many firms are increasingly empowered through technology and the global mobility it makes possible to "choose" among the rules as purchasers of law even though no transnational internal affairs doctrine is in effect.[148] And all the while, fewer network externalities impede entry into the market for law. As a result, the counterweight to regulatory competition envisioned by federal preemption is weaker than scholars have anticipated.

B. LIMITATIONS ON COMPETITION

1. Foreign Issuer Exemptions

Preemption need not result, however, in a pure form of international federalism. Two obstacles are most evident. First, preempted laws are not necessarily imposed on foreign issuers. The U.S. government largely exempts foreign private issuers from onerous obligations to which domestic companies are subject. For example, under Rule 13a-13 of the Exchange Act, foreign private issuers are exempt from filing quarterly reports,[149] and their proxy statements are largely free of some stringent disclosure obligations.[150] Foreign issuers using international financial reporting standards ("IFRS") are also exempt from federal requirements obligating companies to file their accounting statements under U.S. generally accepted accounting principals ("GAAP").[151]

These foreign-issuer exemptions, themselves a response to competitive pressures from foreign markets and a desire to retain foreign-issuer transactions, create what can be considered inefficiencies from the standpoint of regulatory competition. Where foreign issuers are permitted to escape U.S. laws, the pressure for reform is potentially diminished. This

147. Although of course the public-choice story may differ, particularly since national regulators may be subject to a greater degree of domestic constituents, it is likely that they will nonetheless face considerable pressure to promulgate attractive laws. *See* Brummer, *supra* note 109, at 37–41 (describing the domestic law pressures informing the promulgations of securities laws).

148. *See generally* Brummer, *supra* note 109 (finding that advances in technology have made listing on foreign exchanges, and subsequently, the subjection to that nation's securities laws, a much more viable choice for issuers).

149. 17 C.F.R. § 240.13a-13(b)(2) (2007).

150. Specifically, securities registered by foreign private issuers are exempt from the proxy rules under Section 14 of the Exchange Act. 17 C.F.R. § 240.3a12-3.

151. Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675, 681 (2002).

is because where foreign issuers can transact and raise capital without complying with U.S. rules, regulators can continue to draw foreign transactions while still imposing less competitive and perhaps even onerous requirements on domestic companies.

Nevertheless, an incomplete transposition of preempted law may still generate significant competitive pressures for regulators and, as a result, impact the provision of domestic law considerably. Where the government imposes relaxed financial obligations on foreign issuers, it is extremely difficult in the absence of abuse to justify why such rules should not govern domestic companies.[152] Regulators cannot, for example, argue as forcefully for "investor protection" where investors are already permitted to purchase products subject to less supervision. Moreover, where foreign standards become important as overseas financial centers increase in size, harmonization becomes important.[153] Indeed, U.S. companies could even be at a competitive disadvantage when compared to foreign issuers who not only operate under a superior regulatory apparatus, but also can raise money more easily or at lower cost.[154] In such circumstances, incentives for lobbying will increase and lawmakers will draw larger political costs for not extending the benefits of exemption to domestic companies—or curtailing benefits for foreign issuers.[155]

152. *See* Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM L. REV. 1335, 1338 (1996) (noting that if the government lowers standards radically for foreign companies "American companies will surely cry foul and demand equal treatment"). *See also* Larry E. Ribstein, *Cross-Listing and Regulatory Competition*, 1 REV. L. & ECON. 97, 139 (2005), http://www.bepress.com/cgi/viewcontent.cgi?article=1014&context=rle (predicting that the SEC will face pressure from U.S.-based firms to extend benefits of foreign exemptions to domestic firms).

153. In such circumstances, applying different standards to foreign and domestic firms makes interfirm comparisons more difficult. *Id.* at 130. *See also* Paul Diaconu, Sr., Impact of Globalization on International Accounting Harmonization 4 (Jan. 18, 2007) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=958478 (noting how harmonization promotes the comparability of international financial information).

154. *See* Ribstein, *supra* note 152, at 137 (arguing that U.S. firms would incur costs if domestic securities laws disadvantaged them in competing with their foreign-based rivals in capital and product markets).

155. *See id.* (noting that such disadvantages would encourage U.S. firms to use their "greater voice in U.S. politics to lobby for exemptions similar to those accorded foreign-based firms"). It is in large part due to such pressures that domestic issuers have been able to profit from many recent benefits provided to foreign issuers. Indeed, in the wake of Sarbanes-Oxley many of the reforms passed to issuers have been ultimately shared by U.S.-domiciled companies or are in the process of being considered for extension to U.S. companies. U.S. issuers can, for example, file reports with the SEC electronically, and would by definition enjoy overseas selling opportunities. It also is likely that U.S. companies will be able to submit their financial information using international financial reporting standards ("IFRS"). *See* Sarah Johnson, *Goodbye GAAP: It's Time to Start Preparing for the Arrival of International Accounting Standards*, CFO MAGAZINE, Apr. 2008, at 48, *available at*

2. The Problem of Product Bundling

A second systematic inefficiency hampering the development of international federalism is that, even assuming national securities regulators impose preemptive laws on foreign issuers, the competitiveness informing the market for securities law does *not* mean, by itself, that corporate laws are more likely to undergo refinement where they are unattractive to issuers. To understand why, it is important to understand how the intermediation of corporate law through securities regulations creates new legal products for issuers that have important implications for how regulators compete with one another.

For issuers, the promulgation of substantive corporate-governance rules through securities statutes means that firms seeking to list their securities on national stock exchanges must comply with not only traditional securities laws concerning disclosure, but also any embedded corporate laws.[156] Thus, a company in Germany looking to sell its securities in the United States, as a general matter, must comply with not only conventional disclosure requirements, but also Sarbanes-Oxley and its various corporate-governance requirements. This situation differs considerably from the traditional disintermediated regulatory framework. Foreign issuers have historically not had to comply with substantive corporate law in order to tap capital markets.[157] Instead, a foreign private issuer could bypass state incorporation altogether by issuing American Depositary Receipts. In doing so, foreign issuers could avoid U.S. corporate-governance laws, though they would remain subject to securities regulations affecting their offerings.

The inherent bundling of corporate and securities laws thus links corporate governance to the cost of capital much more directly than under the traditional state corporate-law context. Corporate governance becomes a necessary cost (negative and positive) of capital in the same way that disclosure and due diligence comprise costs of capital. As a result, the net cost of capital for issuers, and indeed efficiency, will rely not only on the costs and benefits of securities law, but also on the costs and benefits of intermediated corporate rules.

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http://www.cfo.com/ article.cfm/10919122/c_10941875?f=singlepage (discussing the likelihood that U.S. companies will be able to use IFRS in the future).

156. *See* Lawrence A. Cunningham, *From Convergence to Comity in Corporate Law: Lessons from the Inauspicious Case of SOX*, 1 INT. J. OF DISCLOSURE & GOVERNANCE 269, 271–72 (2004) (describing the "clumsy global reach" of Sarbanes-Oxley).

157. *Id.* at 272.

At the same time, however, bundling diversifies the way in which competition can be carried out. Regulators, on the one hand, can compete in one distinct product market. That is, they can compete in terms of the rules pertaining to corporate or securities law. Thus, under this scenario, where one regulator competes or passes legislation on corporate law, other nations' regulators respond with their own innovations in corporate law. On the other hand, however, because regulators offer bundled products, they may also deploy strategies where competitive disadvantages in one field, such as corporate law, are offset by advantages in securities law. Thus, disadvantages in one jurisdiction such as high incorporation fees may be offset by advantages such as low registration fees for securities.

Recent evidence suggests that U.S. authorities have largely engaged in multisector competition, especially following the large-scale federalization of corporate law realized under Sarbanes-Oxley. This exemplar of substantive corporate governance regulates a variety of internal-affairs concerns—including the internal controls and staffing of auditors and company committees—and in the process has increased the costs of listing in the United States by nearly 35 percent.[158] In the wake of dramatic decreases in the U.S. market share for IPOs in the years following Sarbanes-Oxley, U.S. regulators have sought to make U.S. capital markets more attractive in a variety of ways. Importantly, however, most of the regulatory reforms did not involve changing Sarbanes-Oxley and its federalization of corporate law.[159] Instead, both Congress and the SEC have chosen to make other traditional elements of U.S. securities law more attractive. Thus, instead of dramatically reforming section 404 of Sarbanes-

158. *See* Nikki Swartz, *The Cost of Sarbanes-Oxley*, INFO. MGMT. J., Sept.–Oct. 2003, at 8, *available at* http://goliath.ecnext.com/coms2/gi_0199-3288698/The-cost-of-Sarbanes-Oxley.html. Enacted in the wake of massive accounting and other irregularities perpetrated by corporate giants like Enron and WorldCom, Sarbanes-Oxley "changed corporate governance, including the responsibilities of directors and officers, the regulation of accounting firms that audit public companies, corporate reporting, and enforcement." GUY P. LANDER, WHAT IS SARBANES-OXLEY? 1 (2004). Specifically, Sarbanes-Oxley "enhanced audit committee responsibility and auditor oversight, including prior approval for non-audit services by the auditor and the disclosure of all non-audit services of the auditor." *Id.* at 1–2. In addition, the law required chief executive officers and chief financial officers to certify the accuracy of their companies' annual and quarterly financial reports. Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C. § 7241 (2006); LANDER, *supra*, at 2. Most importantly, it required companies to maintain procedures to evaluate and make certain disclosures concerning their "disclosure controls and procedures" and "internal control over financial reporting." LANDER, *supra*, at 10. *See also* Sarbanes-Oxley Act § 404.

159. For example, a foreign private issuer listing in the United States for the first time is not required to comply with the internal control reporting requirements of section 404 until its second annual report is required to be filed with the Commission. Press Release, Sec. & Exch. Comm'n, SEC Offers Further Relief from Section 404 Compliance for Smaller Public Companies and Many Foreign Private Issuers (Aug. 9, 2006), *available at* http://www.sec.gov/news/press/2006/2006-136.htm.

Oxley, which requires that a company provide two reports regarding its internal control over financial reporting, regulators have made deregistration easier for foreign private issuer companies, thereby lowering the risk of opting into the U.S. securities regime.[160] Securities regulators have also allowed foreign private issuers to use international financial reporting standards in lieu of U.S. GAAP,[161] file information electronically,[162] and are actively considering mutual-recognition regimes which, while incentivizing foreign regulators to adopt U.S. regimes, also enables compliance with foreign securities laws to be substituted for compliance with U.S. securities regulations.[163]

All of the reforms would decrease the cost of doing business in the United States in important ways. By easing deregistration, the legal risks associated with entering U.S. markets are reduced. By easing accounting disclosure requirements and administration, firms are able to reduce transaction costs associated with financing. And mutual recognition, though allowing foreign investors to access U.S. investors from abroad, would also allow U.S. broker-dealers to access foreign markets with fewer transaction costs. In reducing the costs of U.S. regulatory markets, U.S. capital markets would be made again more attractive—despite the stringent requirements of Sarbanes-Oxley.[164]

160. *See* C. Evan Stewart, *The False Promise "Reform*,*"* N.Y. L.J., Feb. 21, 2008, at 23, *available at* http://www.law.com/jsp/nylj/ PubArticleNY.jsp?id=1203508159315#.

161. Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards, Securities Act Release No. 8879, Exchange Act Release No. 57, 206, 73 Fed. Reg. 986 (Dec. 21, 2007).

162. Exemption from Registration for Foreign Private Issuers, Exchange Act Release No. 57,350, 73 Fed. Reg. 10,102 (Feb. 19, 2008).

163. For an outline of such approaches, see Tafara & Peterson, *supra* note 118, at 53–68. For how such regimes may also incentivize reform, see Chris Brummer, Post-American Securities Regulation (Sept. 4, 2008) (unpublished manuscript, on file with author).

164. Even the Supreme Court has worked, wittingly or not, to improve the attractiveness of U.S. capital markets. Specifically, it recently issued a decision in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008), that will likely "curb what business defendants have portrayed as a relentless search by plaintiffs for alternative deep pockets in securities class actions when the main company involved has collapsed." Tony Mauro, *High Court's "Stoneridge" Ruling a Win for Business Defendants*, LEGAL TIMES, Jan. 16, 2008, at 8, *available at* http://www.law.com/jsp/ article.jsp?id=1200391525612. In *Stoneridge*, investor groups sued the cable operator Charter Communications for fraud and also pursued the companies that sold cable boxes that figured in some of Charter's fraudulent transactions. *Stoneridge*, 128 S. Ct. at 766. The Court ruled that the defendant vendors could not be held liable under section 10(b) of the Exchange Act because the investors did not rely on any statements or omissions by the vendors. *Id.* at 769. In effect, the *Stoneridge* ruling shields third-party defendants from broad "scheme liability" for their tangential role in corporate fraud. *See id.* at 770. It is also worth noting that from a procedural perspective, the passage of the Class-Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (codified as amended in scattered sections of 28 U.S.C.), has expanded federal diversity jurisdiction in class actions in an effort to prevent lawyers from

3. Bundling and Legal Efficiency

The potential offsetting effect of product bundling for regulatory competition has important implications for the efficiency of legal rules. Because bundling diversifies the way in which competition can occur, it is not necessarily the case that the corporate laws themselves will be subject to more refinement in the new competitive system, even where other jurisdictions may offer more attractive laws and regimes. Instead, a shortfall in the attractiveness offered in another field will not trigger an immediate loss of market share of securities transactions so long as the total net benefits offered by a jurisdiction are greater than those offered in other jurisdictions. To be sure, the range within which a country can operate without undermining its position is limited, particularly in a market governed by the rivalry available data seems to suggest. But it will have more room than in a competitive environment without such bundling.[165] As a result, even where country X has a more competitive corporate law than country Y, governments may theoretically not face sufficient incentives to reform their laws.

Furthermore, even if regulators in one jurisdiction are incentivized to compete with their foreign counterparts, they may do so asymmetrically—that is, by matching innovations in a competitor's corporate-law structure with better securities regulations. To the consumers of law, of course, any such reform has the effect of reducing the cost of capital. Therefore, consumers will not have a preference as to which form of competition any particular regulator chooses. As a result, it does not necessarily follow that even in the more competitive market for securities laws, intermediated corporate laws will face reform.[166]

As a result, the bundling of legal products potentially distorts competition, at least as compared to the more direct form of competition that internal-affairs doctrine attempts to make possible domestically. Under traditional corporate law, states compete with one another on the basis of corporate law. In the absence of asymmetric supplier incentives, network

"forum shopping" for friendly local venues. Press Release, White House Office of the Press Sec'y, President Signs Class-Action Fairness Act of 2005 (Feb. 18, 2005), *available at* http://www.whitehouse.gov/news/releases/2005/02/20050218-11.html. The bill intends to keep out-of-state businesses, workers, and shareholders from being dragged before unfriendly local juries, or forced into unfair settlements. *Id.*

165. *See supra* Part V.B.2.

166. Of course, the opposite result is also available. By offering bundled products, corporate-governance requirements may be reformed in order to counter reforms made in other jurisdictions in the domain of securities laws. In such circumstances, corporate law will be reformed even where a jurisdiction does not face direct competition in that field from other jurisdictions.

externalities, and other barriers to entry, direct competition would take place. Here, however, the nature of the market for law is very different as legal products are mixed and bundled in different assortments. And because one field of law may be shielded by competitive advantages in another field, even though one jurisdiction may provide the optimal aggregate combination of securities and corporate law, it is not clear whether each individual domain speaks to the preferences of consumers.

C. REVISING THE FEDERAL-STATE MODEL

Ultimately, these observations complicate the impact of preemption when executed through securities law statutes. Federal preemption posits lawmaking in a market animated by more competitors than those arising at the state level, and with less dominance by any one regulator. Just what kind of regulatory impact this dynamic will have is dependent in large part on how the U.S. government responds to this competition. Lawmakers may, as noted above, exempt foreign issuers, though in doing so may spark more domestic law reform. Or they may respond to competition by making other elements of securities law more attractive.

In either case, the international competition facing U.S. securities regulators has deep implications for modeling the impact of preemption and its strategic implications for national regulators. Federal intervention, as noted above, is modeled largely as the primary extrajurisdictional check to Delaware's power and, as such, opens up "a two-front war."[167] Under this view, Delaware must compete with other chartering states to sell corporate charters as well as avoid preemption by federal authorities. Intervention by the federal authorities, in contrast, is posited implicitly as largely a response to egregious rent seeking by Delaware. Thus, under this model, national regulators are viewed as relatively neutral actors with few external pressures.

This view fails, however, to acknowledge that federal regulators, too, are engaged in what can be considered a doubled race. First, they must monitor for market failure and ensure that Delaware is not taking advantage of its dominant market position in the provision of corporate law. And second, they must maneuver to avoid the onslaught of competition from other nations' regulators seeking to attract securities transactions, while at the same time addressing domestic-issuer concerns for equal treatment.

Indeed, national regulators may face even greater incentives than

167. Roe, *supra* note 6, at 639.

present at the state level to provide the most attractive package of law possible to issuers. In the traditional U.S.-federalism context, Delaware must compete in the shadow of a supernational regulator.[168] The threat of preemption thus acts as a discipline to its actions. States "need not fear immediate ouster, but they know that a crisis will attract federal attention and that their corporate law authority might be sapped if it does."[169] On the other hand, in international competition, no such external restraints are on the federal government. Instead, the only external factors that may stymie competition will be the natural competitive advantages one jurisdiction may have over another in liquidity—advantages that, as demonstrated above, are likely insignificant.[170]

The absence of such a supernational monopolist as a result complicates the model of the "strong securities regulator" touting federal regulators to be those actors best positioned (strongest) to cure market failure that arises where states compete in a race to the bottom.[171] Indeed, although securities-law preemption may reduce the number of competitors at the domestic level, and in doing so limit some suboptimal forms of competition, it may also enhance the international competition insofar as rules would be transposed into a more vigorous market for securities law. Preemption may consequently constitute at times a surprisingly weak form of centralization as more, as opposed to fewer, players vie for preeminence as providers of corporate law.

D. A FINAL HYPOTHESIS ON FORM AND SOVEREIGNTY COSTS

These dramatic limitations provoke the obvious and inevitable query: is all lost for federal intervention—is preemption inextricably tied to regulatory competition, and, by extension, sovereignty costs? A brief analysis of the dynamics driving preemption's competition suggests not. Instead, it is more likely that federal regulatory power may depend more on how jurisdiction is exercised and for what use compliance serves for issuing firms.

Consider once again the prospect of federal incorporation, an alternative route to national control where lawmakers would federalize corporate law not through securities statutes but through a federal

168. *Id.* at 635–36.

169. *Id.* at 636.

170. *See supra* Part IV.B.

171. *See* Prentice, *supra* note 30, at 777 (presenting a regulatory competition model, in which all fifty states regulate securities law independently, as an alternative to the "strong-SEC" model currently in place).

incorporation statute. Under this (ultimately unsuccessful)[172] approach espoused by New Deal Progressives over a half century ago, the federal government, through a "Bureau of Corporations," was envisioned to assume power over the supervision and regulation of all corporations doing interstate business and ensure that corporations complied with federal mandates and were trustworthy.[173]

As with U.S. securities law, federal incorporation would serve to dislodge Delaware from its dominant position as a source of corporate law, as well as obliterate the prospect of competition between states. That is, firms wishing to operate in the United States would not enjoy mobility or arbitrage opportunities arising from disparate corporate-law statutes. Instead, the federal government would control the provision of corporate law for any company operating in the territory.

At the same time, however, federal incorporation would not necessarily subject federal lawmakers to the kind of international pressures seen in the securities law context. Because domestic incorporation is not required for securities offerings, the link between federal (corporate law) governance and capital markets would be severed. Although pressure would continue to be placed on the regulation of securities markets, the provision of corporate law would largely escape such pressures.[174]

172. Policymakers and academics viewed large business entities as inevitable as the economy grew though nonetheless sought to subject them to national control. Federal incorporation was a key initiative in such efforts. Proponents of the measure, including then President Theodore Roosevelt, argued: "In the interest of the whole people . . . the Nation should, without interfering with the power of States in the matter itself, also assume power of supervision and regulation over all corporations doing an interstate business." Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1516 (2006). In such a way, good trusts could be encouraged and supervised while bad trusts (monopolies) would be constrained. *Id.* In particular, a Bureau of Corporations was envisioned, if not to mandate certain behavior, then at least to publicize corporations' finances and activities to ensure that "'corporations represented themselves honestly and . . . [abided] by federal rules.'" *Id.* at 1517 (alteration in original) (quoting Melvin I. Urofsky, *Proposed Federal Incorporation in the Progressive Era*, 26 AM. J. LEGAL HIST. 160, 177 (1982)).

173. *Id.* For a sampling of the literature, see generally John W. Brabner-Smith, *Federal Incorporation of Business*, 24 VA. L. REV. 159 (1937) (acknowledging a need to protect the public from abuses of corporate bigness); Cary, *supra* note 1 (asserting a need for the imposition of federal standards of conduct to deter a race to the bottom among states competing to attract corporations through corporate-friendly law); Joseph C. O'Mahoney, *Federal Charters to Save Free Enterprise*, 1949 WIS. L. REV. 407 (asserting a need to impose federal standards on corporate law so as to prevent monopoly and excessive concentration of economic power by the states); Donald E. Schwartz, *Federal Chartering of Corporations: An Introduction*, 61 GEO. L.J. 71 (1972) (maintaining that state chartering has failed); H.L. Wilgus, *Need of a National Incorporation Law*, 2 MICH. L. REV. 358 (1904) (arguing that state law laxity requires federal intervention).

174. Of course, the decoupling of capital markets from corporate law does not mean that governments will not face pressure to provide attractive corporate laws. To the extent to which the costs on corporations are prohibitive, companies could still pressure governments to provide attractive laws.

Federal regulators, as a result, would enjoy more slack in making their regulatory decisions. Although authorities would still face direct or indirect pressure from local constituents to promulgate efficient or attractive rules for the governance of corporations, regulated firms would not necessarily enjoy unilateral mobility. Indeed, especially where federal laws operate as preconditions to doing business in the country, and not only raising capital, firms could not simply move their statutory situs in the face of unattractive regulation. Regulators thus would likely internalize fewer costs than would be the case under the promulgation of securities regulations. To be sure, given the size of the U.S. economy, even foreign firms would be required to comply with little threat of detection elsewhere.

These divergent regulatory consequences suggest that market power does not derive exclusively from the level of governmental regulation by firms, but may instead depend on the critical resource for which compliance is required. As mentioned above, in its purest form, corporate law defines the ways in which individuals may structure and centralize capital in one organizational form in order to access product markets with certain (often necessary) characteristics such as limited liability and centralized entity action.[175] Securities law, in contrast, relates to a very different kind of resource—capital markets—and outlines the requirements that must be fulfilled in order for firms to access investors and raise money. This substantive divergence is important because the two have different values to firms. As gateways to product markets, corporate law is necessary. As firms become larger and saturate their home markets, expansion into other product markets becomes necessary in order to preserve profitability. Though firms may be able to choose where to do business, there may be a cost of not doing business in a particular location. Meanwhile, in an age of global liquidity, capital markets do not necessarily create the same economic necessity. If a country imposes onerous regulatory costs on firms seeking to access its capital market, a firm can look to tap markets elsewhere.

Tying corporate law to commoditized capital markets has, as a result, overlooked and undertheorized implications for competition. Because many firms looking for capital are mobile and have choices, regulators are

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The likelihood, however, of such costs being prohibitive are small. As discussed earlier, incorporation constitutes a relatively small resource outlay for firms. *See supra* note 60. They would not, however, face the same pressures from the investment banking and legal community. These individuals would continue to do deals to the extent to which the aggregate costs diminished the net volume of securities transactions.

175. *See* Blair, *supra* note 33.

forced to internalize the costs of their decisionmaking insofar as poor regulations will incentivize firms to tap other (foreign) markets. Indeed, it is possible for even domestic firms to bypass these preempted corporate-law imperatives by seeking foreign capital abroad. Thus, in linking law to jurisdictional resources where regulators have less monopoly power, regulatory power will remain weak. Where, on the other hand, regulations are promulgated as discrete and disaggregated requirements for enjoying purely legal benefits tied to domestic product markets, regulators will likely wield stronger market power.

It is consequently plausible that federalization may very well continue to be a useful means of achieving regulatory monopoly. The degree to which it will be able to serve as such a tool in the corporate-law context, however, may increasingly depend on the way in which federalization is itself structured. Preemption's power will not rely only on the primacy of the regulator within a jurisdiction. Instead, it will also be tied to the availability of the goods elsewhere. From this perspective, bundling laws to commodities like capital markets likely generates sovereignty costs that may paradoxically diminish, as opposed to increase, regulatory control.

VI. CONCLUSION

This Article has demonstrated that far from monopolizing the provision of law, preemptive securities regulation helps facilitate regulatory competition. By decoupling the provision of corporate law from an interstate market that in some ways lacks vigorous competition by states and linking it instead to an intensifying global race for securities transactions, federalization operates as an enabling mechanism for a new and underanalyzed system of international federalism. Preemptive securities regulation thus can be viewed as operating on two different fronts. On the one hand, national authorities monitor the market for corporate law to ensure that Delaware is not taking advantage of its monopolist position as the primary supplier of rules. On the other hand, however, U.S. lawmakers must also cope with the onslaught of vigorous competition from other nations' regulators seeking to draw securities transactions to their home markets. As a result, preemption is likely a weaker counterweight to any regulation among states than scholars have predicted.