Article

State Enforcement of National Policy: A Contextual Approach (with Evidence from the Securities Realm)

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INTRODUCTION

How authority should be allocated as between the states and federal government is a topic of perennial debate. The vogue in federalism scholarship today is to celebrate a model of overlapping state-federal authority that has been labeled in varying ways as "cooperative," "polyphonic," "dialectic," "interactive," "intersystemic," and even at times "uncooperative" (but in a good way).[1] For simplicity, I will use the label "cooperative federalism." Whatever the moniker, the basic idea is that a variety of benefits can flow from having multiple layers of government concurrently address an area of regulatory concern. Recent focus has been placed on the benefits of concurrent enforcement authority in particular—i.e., the ability of state regulators to either directly enforce federal laws, or to enforce state laws that substantively and jurisdictionally overlap with federal laws.[2] This spike in interest in concurrent enforcement may

1. *See, e.g.*, ROBERT A. SCHAPIRO, POLYPHONIC FEDERALISM 7 (2009) [hereinafter SCHAPIRO, POLYPHONIC FEDERALISM]; Robert B. Ahdieh, *Dialectical Regulation*, 38 CONN. L. REV. 863, 868 (2006); Jessica Bulman-Pozen & Heather K. Gerken, *Uncooperative Federalism*, 118 YALE L.J. 1256, 1258 (2009); Robert A. Schapiro, *Toward a Theory of Interactive Federalism*, 91 IOWA L. REV. 243, 243 (2005) [hereinafter Schapiro, *Interactive Federalism*]; *see also* ERWIN CHEMERINSKY, ENHANCING GOVERNMENT 225 (2008).

2. *See, e.g.*, Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15, 56–57 (2010); Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. REV. 698, 699–704 (2011); Amy Widman & Prentiss Cox, *State Attorneys General's Use of Concurrent Public Enforcement Authority in Federal Consumer Protection Laws*, 33 CARDOZO L. REV. 53, 53 (2011).

be attributable to controversial provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 which authorize state regulators to enforce the Consumer Financial Protection Bureau's rules, while also preserving their authority to enforce more pro-consumer state laws.[3] But state and federal regulators share enforcement authority in numerous legal areas beyond consumer protection, including antitrust, securities fraud, and wide swaths of environmental and criminal law.[4] Moreover, a debate currently rages over the ability of states to aid in the enforcement of federal immigration laws.[5] The topic is thus one of broad public policy significance.

The benefit of concurrent enforcement most emphasized in this recent literature is the ability of state regulators to remedy under-enforcement by potentially captured federal agencies.[6] Other heralded benefits include the additional resources and local knowledge that state enforcement brings to the table, as well as the increased opportunities for citizen influence.[7] The costs tend to be given only cursory attention. But that ground has been well trodden in the past by proponents of "competitive federalism."[8] Competitive federalists favor granting states exclusive authority in regulatory areas where inter-jurisdictional competition is believed to lead to better government, and granting the federal government exclusive authority in regulatory areas where a uniform national policy is desirable[9]—more in

3. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); *see* Barkow, *supra* note 2, at 75–76 (discussing the political debate over this "hotly contested issue"); Widman & Cox, *supra* note 2, at 60 (same).

4. *See, e.g.*, NORMAN ABRAMS, FEDERAL CRIMINAL LAW AND ITS ENFORCEMENT 109 (4th ed. 1986) (criminal); AM. BAR ASS'N, THE CLEAN AIR ACT HANDBOOK 494 (Robert J. Martineau, Jr. & David P. Novello eds., 1998) (environmental); *infra* note 88 (antitrust); *infra* Part III (securities).

5. *See, e.g.*, Arizona v. United States, 132 S. Ct. 2492 (2012) (ruling on preemption claims directed towards Arizona's controversial S.B. 1070); Gabriel J. Chin & Marc L. Miller, *The Unconstitutionality of State Regulation of Immigration Through Criminal Law*, 61 DUKE L.J. 251, 253–55 (2011) (discussing copycat bills recently adopted in many other states).

6. *See infra* Part I.B.1.

7. *See infra* Part I.B.2–3.

8. For a discussion of the competitive challenge to cooperative federalism, see John Kincaid, *The Competitive Challenge to Cooperative Federalism: A Theory of Federal Democracy*, *in* COMPETITION AMONG STATES AND LOCAL GOVERNMENTS: EFFICIENCY AND EQUITY IN AMERICAN FEDERALISM 87–114 (Daphne A. Kenyon & John Kincaid eds., 1991).

9. For the classic works in this area, see Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956), and WALLACE E. OATES, FISCAL FEDERALISM (1972). *See also* Frank H. Easterbrook, *Antitrust*

line with the "dual federalism" that reigned in the pre-New Deal era.[10] They emphasize the potential for concurrent enforcement to create wasteful redundancies in enforcement expenditures, distort policy goals, and undermine democratic accountability.[11]

Both sides of this rather polarized debate make important contributions. But the discussion is too abstract. Unless one takes the position that more (or less) government is an unqualified good unto itself, concurrent enforcement cannot sensibly be applauded (or derided) at a trans-substantive level. In some regulatory areas, the benefits of shared enforcement authority may outweigh the costs; in others, the opposite may be true. *Context is critical*. While scholars have recognized the need for case studies to evaluate concurrent enforcement's desirability in particular regulatory settings,[12] missing from the existing literature is clear guidance on what factors should be looked to in conducting the necessary cost-benefit calculation. Without such guidance, principled distinctions between concurrent enforcement authority in disparate fields like environmental protection and immigration law are difficult to draw, and the risk exists that case studies will simply weigh the rather amorphous costs and benefits of concurrent enforcement in whatever way supports the author's political preferences. This Article seeks to bring some much needed discipline to debates over concurrent state-federal enforcement by providing a systematic account of the variables that will influence its desirability in different regulatory settings. To illustrate the significance of these variables, the Article also provides an empirically

and the Economics of Federalism, 26 J.L. & ECON. 23, 33–35, 38 (1983) (discussing the pre-conditions for efficient interjurisdictional competition and identifying regulatory problems that require a national solution); Richard A. Epstein, *Exit Rights Under Federalism*, 55 LAW & CONTEMP. PROBS. 147, 147–48 (1992) (same).

10. For a discussion of Supreme Court cases decided in this era holding that state and federal power operate in exclusive realms, see Stephen Gardbaum, *The Breadth vs. the Depth of Congress's Commerce Power: The Curious History of Preemption During the* Lochner *Era*, *in* FEDERAL PREEMPTION: STATES' POWERS, NATIONAL INTERESTS 48, 57–62 (Richard A. Epstein & Michael S. Greve eds., 2007).

11. *See infra* Part I.A.

12. *See, e.g.*, Barkow, *supra* note 2, at 79 ("Future research will need to assess the strengths and tradeoffs . . . [in] specific regulatory contexts."); Bulman-Pozen & Gerken, *supra* note 1, at 1308 (observing that "[c]ase studies are likely to be especially important, as every administrative scheme is different," and "would be particularly helpful in adding needed texture to the story about states" offered).

grounded case study of one of the longest standing, and most fraught, areas of concurrent state-federal enforcement: securities fraud enforcement against nationally traded firms.

This Article's first contribution is to identify the contextual factors that influence the magnitude of the costs and benefits produced by concurrent state-federal enforcement. These factors are discussed in Part II, and first among them is the purpose of federal intervention in the regulatory area under examination. Debates over the desirability of concurrent enforcement between persons with different views on the purpose of federal intervention—or on the wisdom of having the federal government involved in the particular regulatory area at all—will necessarily be incoherent. Only common answers to these first order federalism questions can give way to reasoned debate on the second order question of optimal enforcement design. For example, the case for concurrent state enforcement is much easier to make when federal laws are warranted as a means for preserving a base level of national rights, or of preventing so-called "races to the bottom," than when federal laws are warranted as a means for dealing with interstate externalities generated by state-level regulation. In the former cases, states truly can use their enforcement authority to innovate and experiment "without risk to the rest of the country,"[13] because their enforcement policies do not threaten to distort national policy goals. Moreover, the lines of democratic accountability remain fairly clear. When federal intervention is warranted to deal with interstate externalities, by contrast, policy distortion and democratic concerns take on greater prominence. Concurrent enforcement may still have a beneficial role to play, but to determine whether this is likely to be the case requires a careful analysis of additional context-specific factors.

Several structural factors will influence the costs and benefits of shared enforcement authority when interstate externalities justify federal intervention. As fleshed out in Part II.B, these include the breadth of the substantive prohibition being enforced, whether states are enforcing federal law or analogous state laws, the number of states with overlapping jurisdiction, and the type of safeguards (if any) that are built into the concurrent enforcement regime. These easily observable factors can help predict concurrent enforcement's potential in different regulatory settings. For example, if only one state has concur-

13. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

rent jurisdiction to enforce a fairly narrow federal law, subject to federal oversight, the potential costs are much smaller than if numerous states share unfettered jurisdiction to enforce broad state laws that overlap with, but may vary from, federal law.

If these structural features suggest that concurrent enforcement may create significant costs, an assessment of the enforcement behavior of federal and state regulators becomes essential to determining concurrent enforcement's desirability. Does the federal agency with enforcement authority err on the side of under-enforcement (or would it if granted an enforcement monopoly)? If the answer is no, state enforcement is not needed as a means to correct for lax federal efforts—the primary benefit of concurrent state enforcement stressed in recent literature. Even if the federal regulator does (or would) under-enforce, or there is empirical uncertainty as to whether that is the case, state enforcement will be desirable only if it does more good (by correcting for this tendency or producing other benefits) than harm (by distorting legitimate policy goals or producing other costs). Thus, it is also critical to understand how state regulators actually use their concurrent enforcement authority.

Theory supports different hypotheses about how states might behave, with different implications for the desirability of concurrent enforcement. Consistent with positive accounts of concurrent enforcement, state regulators might engage in desirable "vacuum filling"—stepping in to bring enforcement actions when federal regulators should, but do not; or, state and federal regulators might act cooperatively, efficiently sharing the enforcement burden in ways that play to each enforcer's comparative advantage. Consistent with negative accounts of concurrent enforcement, state regulators might alternatively use their enforcement authority to engage in "rent seeking"—bringing actions that advance their state's parochial interests at the expense of the nation at large. State regulators might also use their concurrent enforcement authority to promote their personal political ambitions, with more ambiguous effects on social welfare. These divergent claims about state enforcement behavior are often asserted, but rarely tested. Empirical research is necessary to determine which state motivations dominate in a particular regulatory context.

This Article's second contribution—a case study of concurrent state-federal enforcement of securities fraud laws against nationally traded firms—helps to illustrate these points. Part

III analyzes concurrent enforcement's potential in the securities fraud context with an eye to the contextual factors described above. It explains that state efforts to deter fraud in the national capital markets can create both positive and negative interstate externalities, and posits that federal laws to promote optimal securities fraud deterrence are justified for this reason. It further explains how the structural factors identified in Part II.B counsel that concurrent state enforcement in this context is likely to be costly: fraud prohibitions tend to be broadly written and prone to legal error; state regulators do not enforce federal fraud prohibitions, but enforce their own state fraud laws; multiple states share jurisdiction; and there are no safeguards built into the system that allow for federal oversight of state enforcement efforts. This does not decide the case against concurrent state enforcement, however, as many scholars also believe that the Securities and Exchange Commission (SEC), the primary federal securities law enforcer, under-enforces. The desirability of concurrent enforcement thus turns heavily on how state regulators actually use their enforcement authority. Those who favor maintaining a concurrent state role assume that state enforcers do more good than harm, by filling federal enforcement gaps or working cooperatively with the SEC; those who favor preemption assume state enforcers do more harm than good, by bringing actions that benefit the state enforcer at the expense of the national capital markets. Unfortunately, these assumptions have been based more on intuition than data. What is known about state enforcement has come almost exclusively from anecdotal accounts of activity by New York's Attorney General, without a good sense of what securities regulators in the other forty-nine states have been doing.

To help clarify this empirical uncertainty over the desirability of concurrent state-federal securities fraud enforcement, this Article uses a large, unique dataset—which contains information gathered from the litigation disclosures in over 5000 annual reports filed with the SEC by nearly 2000 public companies—to test the various hypotheses about state enforcement behavior described earlier. I label these the "Vacuum Filling," "Cooperation," "Rent Seeking," and "Political Entrepreneur" hypotheses. As discussed in Part IV, the results of quantitative and qualitative testing of these hypotheses suggest each has some explanatory power, leading to the conclusion that state enforcement in the securities area has had mixed social welfare effects. For example, while some states (like New York) have arguably used their enforcement authority to fill federal enforcement vacuums, others (like West Virginia) have seemingly used it to engage in rent seeking. These findings leave the desirability of concurrent state enforcement uncertain, but they do have prescriptive implications: they invite incremental reforms designed to preserve concurrent state enforcement's positive potential, while mitigating its ability to do harm to our national capital markets. Part IV.C identifies several potential reforms in this vein.

The case study offered here is important because it advances the long-standing debate over the optimal design of the U.S. securities fraud deterrence regime.[14] It also illustrates the type of reasoned contextual analysis that can and should be applied in the numerous other regulatory areas that utilize concurrent state-federal enforcement. Of course, in another regulatory area federal intervention may have a distinct purpose that leads to a different conclusion about state enforcement's potential costs and benefits, or the structural features of the concurrent enforcement regime may be such that state enforcement is not as worrisome, or it may be that the relevant federal or state regulators have a different track record that leads to different conclusions about the optimal allocation of enforcement authority. The point to take away is that although contexts differ, a sophisticated analysis of a concurrent state-federal enforcement regime requires more than an ad hoc—and potentially biased—weighing of costs and benefits. Attention to the context-specific factors identified in this Article is critical to distinguishing, on a principled basis, the settings where concurrent state enforcement is likely to be beneficial and those where it is likely to be detrimental, or at least of questionable value. Cases studies attentive to these factors might also help identify creative reforms that could improve the functioning of a concurrent enforcement regime notwithstanding empirical uncertainty regarding federal and state enforcement behavior, as this Article's case study does in the securities fraud context.

The remainder of this Article proceeds as follows. Part I provides a brief overview of the costs and benefits traditionally associated with concurrent state-federal enforcement regimes. Part II identifies a variety of contextual factors that will affect the magnitude of these costs and benefits, and which must be considered before any judgment can be made about concurrent

14. *See infra* note 123.

enforcement's desirability in a particular regulatory setting. Applying this learning, Part III provides a case study of concurrent enforcement of securities fraud laws against nationally traded firms. That case study is continued in Part IV, which reports empirical findings on enforcement behavior by state securities regulators and discusses the implications of these findings for reform. The Article then briefly concludes.

I. CONCURRENT ENFORCEMENT: COSTS AND BENEFITS

Concurrent state-federal enforcement regimes are commonplace in the United States today. State regulators[15] are sometimes authorized to enforce federal laws.[16] They also frequently retain authority to enforce state laws in situations where federal laws exist that target the same misconduct.[17] Proponents of competitive federalism are quick to point out the costs of concurrent state-federal enforcement authority,[18] whereas proponents of cooperative federalism tend to trumpet its benefits.[19] This Part provides a brief but balanced catalogue of both the costs and benefits that scholars have associated with concurrent state-federal enforcement regimes. The next Part demonstrates the highly contextual nature of the cost-benefit calculation.[20]

15. Throughout I use this term broadly to encompass all varieties of state enforcers, including state attorneys general, as well as appointed agency heads.

16. This is most common in the antitrust and consumer protection areas. *See* Widman & Cox, *supra* note 2, at 55–57 (discussing twenty-four federal laws that explicitly grant enforcement power to the state).

17. This will be the case in numerous areas where Congress has legislated without expressly or impliedly preempting analogous state laws.

18. *See generally* Michael S. Greve, *Against Cooperative Federalism*, 70 MISS. L.J. 557 (2000).

19. *See, e.g.*, Ahdieh, *supra* note 1, at 867–70 (noting costs but focusing on unappreciated benefits of jurisdictional redundancy); Bulman-Pozen & Gerken, *supra* note 1, at 1260 ("[W]e focus on the affirmative case for the role that uncooperative federalism can play in a well-functioning federal system."). In their books, Professors Chemerinsky and Schapiro both take a normative position in favor of overlapping authority. *See* CHEMERINSKY, *supra* note 1; SCHAPIRO, POLYPHONIC FEDERALISM, *supra* note 1; *see also* WILLIAM W. BUZBEE, PREEMPTION CHOICE 3 (2009) (stating that "virtually all chapters in this book contribute to the development of normative arguments" in favor of jurisdictional overlap).

20. Two words about the scope of this Article are in order. First, the Article focuses on enforcement. When it comes to the promulgation of legal rules, as well as their implementation through regulatory programs, the relationship between the states and the federal government can be even more complex. For interesting discussions of the legal issues that can arise from this brand of co-

A. COSTS

The costs typically associated with concurrent enforcement regimes include added expense, the potential for policy distortion, and a loss of democratic accountability.

1. Expense

When state and federal enforcers monitor for the same misconduct, the total outlay of government resources is likely to be higher than if a single enforcer did the job alone. The same is true when state and federal enforcers pursue the same instance of misconduct, at least in an uncoordinated way. From the perspective of regulated parties, the expense of defending against multiple investigations or lawsuits is likely to be higher than defending against a single investigation or lawsuit, in terms of both out-of-pocket legal costs and time and distraction[21]; moreover, settlement discussions are more complicated.[22] Facing concurrent state and federal enforcement also imposes ex ante costs on regulated parties, as they must monitor the enforcement decisions of more actors in order to ensure their compliance with the law (as interpreted by the various enforcers) and adjust their behavior accordingly.[23] If regulated parties operate or sell goods in multiple states, they may face a "bal-

operative federalism, see Abbe R. Gluck, *Intrastatutory Federalism and Statutory Interpretation: State Implementation of Federal Law in Health Reform and Beyond*, 121 YALE L.J. 534 (2011), and Jim Rossi, *Dual Constitutions and Constitutional Duels: Separation of Powers and State Implementation of Federally Inspired Regulatory Programs and Standards*, 46 WM. & MARY L. REV. 1343 (2005). Second, this Article focuses on how best to allocate enforcement authority as a matter of policy. It ignores—and takes no position regarding—the constitutional dimension of the federalism question. *Cf.* Edward L. Rubin & Malcolm Feeley, *Federalism: Some Notes on a National Neurosis*, 41 UCLA L. REV. 903, 909 (1994) (arguing that the "Supreme Court should never invoke federalism as a reason for invalidating a federal statute or as a principle for interpreting it").

21. *See, e.g.*, SCHAPIRO, POLYPHONIC FEDERALISM, *supra* note 1, at 291 (observing that if "federal and state regulations both apply, federal and state authorities may each seek to enforce the laws in separate, uncoordinated proceedings," increasing costs and undermining finality).

22. *See, e.g.*, Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 925, 940 (2001) (observing that concurrent enforcement in the antitrust context serves "to lengthen the original lawsuit, complicate settlement, magnify and protract the uncertainty engendered by the litigation, and increase litigation costs").

23. *See, e.g.*, SCHAPIRO, POLYPHONIC FEDERALISM, *supra* note 1, at 290 ("Keeping track of multiple obligations may tax individuals and firms, especially those operating in more than one state.").

kanized" landscape of regulatory obligations, increasing the cost of doing business.

2. Policy Distortion

Another cost of concurrent enforcement is its potential to detract from coherent policy. How the law is enforced can influence behavior as much as, and sometimes even more than, how the law is written. The particular misconduct that enforcers choose to target, their investigative methods, the type and level of sanctions that they seek to have imposed (whether judicially or through settlement), and the frequency at which they choose to prosecute can powerfully affect the behavior of regulated parties. A monopolistic enforcer can control, and adjust, its enforcement choices in order to achieve desired policy outcomes.[24] Introducing multiple enforcers makes these policy levers more difficult to utilize effectively.[25] Policy distortion can result from mere lack of coordination and communication between enforcers. But it can also result when different enforcers have different views on what the appropriate policy should be.[26] When this occurs, the more aggressive enforcer's viewpoint will always win out, creating a one-way ratchet as regulated parties adjust their behavior to conform to the demands of the strictest enforcer with jurisdiction over them.[27]

That concurrent state-federal enforcement regimes may lead to this sort of policy distortion is not far-fetched. Federal and state enforcers are likely to have differing policy perspectives for a variety of reasons. For example, federal enforcers should be concerned with maximizing national welfare, whereas state enforcers should be concerned with maximizing the welfare of their particular state. This may lead states to pursue actions that are in their parochial interest, but which are not in

24. *See, e.g.*, Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2194–97 (2010) (discussing use of prosecutorial discretion in the securities fraud context).

25. *See id.* at 2204–05 (explaining how concurrent enforcement complicates effective use of prosecutorial discretion); *see also* Lemos, *supra* note 2, at 703 ("[S]tate-level variation in enforcement (as in regulation) can produce inefficient and undesirable policy outcomes.").

26. *See, e.g.*, Lemos, *supra* note 2, at 749 (highlighting conflict between state and federal enforcement agencies over marijuana possession).

27. *See* Ahdieh, *supra* note 1, at 889–90 (acknowledging that "intersystemic regulation may serve as the handmaiden of over-regulation" by creating a "one-way competitive ratchet"); Lemos, *supra* note 2, at 749 ("[T]he ratchet only moves in one direction: toward more enforcement."). This assumes that regulated parties cannot easily escape the jurisdiction.

the best interest of the nation as a whole. Moreover, federal enforcers are often embedded in administrative agencies, which are staffed by experts and designed to promote nonpartisan decisionmaking.[28] State enforcers, by contrast, are often elected generalists, making them potentially more sensitive to populist demands and less sensitive to the more diffuse costs of excessive regulation.[29] Finally, the party affiliation of state enforcers may differ from the party affiliation of the President or the majority in Congress, both of whom stand in a position to influence the enforcement policies of federal administrative agencies.

3. Loss of Accountability

The potential for policy distortion is tied to another frequently cited cost of concurrent enforcement: a loss of democratic accountability.[30] When multiple enforcers are responsible for shaping policy, it becomes more difficult for the electorate to monitor them and to accurately assign blame or praise for policy outcomes.[31] This may negatively affect enforcement behavior by eroding discipline; it also creates incentives for enforcers to free-ride on the efforts of others, which may lead to less vigorous enforcement overall.[32]

Even more troublesome, if enforcers from a particular state shape policies with a nationwide impact, non-state residents

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28. *See id.* at 701 (describing the typical agents of federal enforcement as "appointed[] specialist[s]").

29. *See id.* at 700–01 (explaining that state enforcers have different incentives than federal enforcers, both because they seek to vindicate state rather than national interests and because state officials tend to be political actors, unlike federal bureaucrats); *see, e.g.*, Timothy Meyer, *Federalism and Accountability: State Attorneys General, Regulatory Litigation, and the New Federalism*, 95 CALIF. L. REV. 885, 890 (2007) (discussing how political ambiguities can affect the enforcement incentives of state attorneys general).

30. *See* Greve, *supra* note 18, at 584 ("Even defenders of cooperative arrangements agree that cooperative federalism diffuses political accountability and responsibility.").

31. *See* Ahdieh, *supra* note 1, at 897 (explaining that regulatory overlap may diminish the quality of oversight because there are more regulators to monitor). A similar concern has been voiced in the Supreme Court's Commerce Clause and anti-commandeering jurisprudence. *See Schapiro, Interactive Federalism*, *supra* note 1, at 291–92.

32. *See* Ahdieh, *supra* note 1, at 897–98 (observing that regulatory overlap may cause regulators to free ride "on the expected contributions of one's counterpart agency" and allows them to shift the blame to others in the event of regulatory failure—creating a "regulatory commons"); Barkow, *supra* note 2, at 56 ("When only one agency has responsibility for enforcement, it is more likely to be diligent in pursuing that task because it knows it will be accountable for any failures.").

must live with the consequences despite their inability to exert influence on the state enforcer through the ballot box.[33] To be sure, these citizens have a voice through their representatives in Congress, and Congress can almost always strip states of their enforcement authority.[34] But preemption is a blunt instrument and one that is extremely difficult to convince Congress to pick up.[35]

Finally, use of concurrent state-federal enforcement may undermine broader separation of powers values at both the federal and the state level. At the federal level, Congress may favor state enforcement as a way to weaken executive influence.[36] At the state level, legislative checks are weakened when state enforcers are authorized to enforce federal laws that state legislatures have not, and would not, pass. Of course, the President could veto legislation that created or preserved a role for concurrent state enforcement, just as state legislatures could pass laws stripping state enforcers of authority to enforce federal

33. *See* Lemos, *supra* note 2, at 741 ("[S]tates' enforcement efforts may have nationwide consequences because of their impact on the regulated community, even if the law on the books remains the same. One state's aggressive enforcement can prompt potential defendants to change their practices across the board."); Meyer, *supra* note 29, at 910 ("Because an industry will often find it cheaper to change its national operations rather than its operations in only a group of states, lawsuits seeking to change the way in which businesses operate can have national effects without national input.").

34. *See, e.g.*, Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 637 (2004) (observing that "voters throughout the country [have] an opportunity to persuade Congress to preempt those state law provisions that lack popular support"); Donald C. Langevoort, *Federalism in Corporate/Securities Laws: Reflections on Delaware, California, and State Regulation of Insider Trading*, 40 U.S.F. L. REV. 879, 892 (2006) (suggesting the preemption threat mitigates state overreaching in the securities context).

35. *See, e.g.*, Renee M. Jones, *Dynamic Federalism: Competition, Cooperation and Securities Enforcement*, 11 CONN. INS. L.J. 107, 114–16 (2004) (highlighting an example in which even strong lobbying by business groups and prominent federal government officials was not enough to get Congress to preempt state enforcement).

36. *See* Gluck, *supra* note 20, at 573 (observing concurrent state enforcement "might assuage concerns of [federal] legislators who are suspicious of, or politically opposed to, the current executive branch's policy agenda" and noting that "[w]ork in the political science realm has, indeed, documented an increase in such delegations toward the states and away from the federal government in times of divided government"). Of course, if one believes that executive influence is outsized today, and thus itself an affront to separation of powers values, state enforcement might be viewed as a valuable corrective. *See generally* Jessica Bulman-Pozen, *Federalism as a Safeguard of the Separation of Powers*, 112 COLUM. L. REV. 459 (2012).

laws, but, as with preemption, these are blunt and costly—and therefore imperfect—remedies.[37]

B. Benefits

A variety of benefits have also been recognized to flow from concurrent state-federal enforcement, including most notably the ability of state enforcers to remedy federal under-enforcement. Some have also argued that state enforcers possess certain advantages over federal regulators, such as greater knowledge and expertise about local conditions, which can foster regulatory tailoring and innovation. Relatedly, state enforcement may increase opportunities for citizen influence.

1. Remedying Federal Under-Enforcement

By far the benefit of concurrent state-federal enforcement most stressed in the literature is the ability of state enforcers to make up for lax enforcement by federal agencies.[38] Federal agencies may under-enforce due to resource constraints, which state enforcement budgets and existing infrastructure can help alleviate.[39] More troubling, under-enforcement may also result from poor regulatory incentives. Federal enforcement agents may take an excessively light touch because they are captured by regulated parties, because they hope to increase their chances of exiting the agency through a "revolving door," or simply because it is easier than working hard.[40] State enforcers can help to fill enforcement gaps that result and can discipline federal agencies going forward by threatening to expose en-

37. To be sure, if the state enforcer is an elected officer, and the federal enforcer is an appointed bureaucrat, concurrent state enforcement may also increase accountability. This possibility is discussed *infra* at Part I.B.3. If elected state enforcers in turn delegate enforcement to the private bar, however, new accountability concerns are introduced. *See infra* Part IV.B.1.d. (discussing the practice of West Virginia's Attorney General to hire private lawyers to litigate matters on behalf of the state).

38. *See, e.g.*, Ahdieh, *supra* note 1, at 885–88 (explaining how overlapping state-federal jurisdiction can help overcome regulatory inertia by creating a "fail-safe" system of redundancy that protects against under-regulation); Schapiro, *Interactive Federalism*, *supra* note 1, at 290 (same).

39. *See* Barkow, *supra* note 2, at 58 ("State AGs can . . . serve a valuable equalizing function by bringing enforcement actions when a federal agency shares the state's outlook on regulation but lacks the resources to police all infractions."); Lemos, *supra* note 2, at 721 (observing that "[s]tates may have an investigatory or enforcement apparatus in place—a local police force, for example—that would be costly for the federal government to replicate").

40. *See* Rose, *supra* note 24, at 2212–19 (discussing the assumptions underlying claims that federal enforcers will systematically under-deter).

forcement failures.[41] Indeed, state enforcement has been likened to other administrative law tools designed to improve the performance of independent federal agencies—such as removal protection for agency heads, multimember structures, and exemptions from cost-benefit review of proposed rules by the Office of Information and Regulatory Affairs.[42]

State enforcers may be inclined to play this "agency watchdog" role because, as discussed earlier, they face different incentives than federal enforcers. These differing incentives may be detrimental if they operate to distort welfare-enhancing federal policies, but they can also be beneficial if they cure welfare-destroying federal policies. Because they are accountable to a different set of constituencies, it may prove harder for regulated parties to capture state enforcers than a federal enforcer.[43] Capture will also be harder—or at least more expensive—simply because in a concurrent enforcement regime there are more enforcers that must be captured to ensure the desired level of under-enforcement. The revolving door may also be less available to state enforcers, removing that temptation to deviate from optimal regulatory policy.[44] Finally, when multiple enforcers are tasked with regulating the same misconduct, competitive instincts may kick in—particularly for enforcers with political ambitions—overcoming incentives to take the easier path.[45]

2. Local Advantages

It is often observed that state enforcers may better understand local conditions or have better access to relevant evidence, giving them an advantage over federal enforcers located

41. *See* Lemos, *supra* note 2, at 748–49 ("[T]he potential for . . . gap-filling by individual states should reduce the likelihood of nonenforcement at the outset.").

42. *See* Barkow, *supra* note 2, at 15; *see also* Gillian E. Metzger, *Federalism and Federal Agency Reform*, 111 COLUM. L. REV. 1, 70 (2011) (articulating "the belief that states are likely to be particularly effective monitors of [federal] agencies and instigators of administrative change").

43. *See, e.g.*, *id.* at 56–57 (noting that state AGs "often win elections by appealing to broad consumer interests.").

44. *See* REVOLVING DOOR WORKING GRP., A MATTER OF TRUST: HOW THE REVOLVING DOOR UNDERMINES PUBLIC CONFIDENCE IN GOVERNMENT—AND WHAT TO DO ABOUT IT 85 (2005) (explaining that more than half the states have revolving door restrictions for senior-level government employees).

45. *See* Schapiro, *Interactive Federalism*, *supra* note 1, at 287 (highlighting the importance of "state-federal competition for the affections of the people").

in Washington or regional field offices.[46] They may also be more available to the local citizenry, facilitating a greater flow of information and, as a result, higher detection rates.[47] State enforcers may use this knowledge and access to tailor their enforcement efforts to local needs. The multiplicity of enforcement approaches that states adopt may, in turn, facilitate cross-jurisdictional learning, leading to an improvement of the enforcement regime overall.[48]

3. Citizen Participation

As discussed above, concurrent state-federal enforcement is often associated with a loss of democratic accountability. But it can also pay democratic dividends by increasing the opportunity for citizen influence. It has been observed that "[s]tate enforcers may be more accessible and responsive [to citizens] than federal agencies, both because states are smaller units of government and because state attorneys general tend to be elected rather than appointed."[49] In addition, concurrent state-federal authority can create "an incentive for state and federal officials to disseminate information about who is to blame for a problem," thus ensuring that "the people with the most information about who is responsible—and the greatest ability to

46. *See* Lemos, *supra* note 2, at 721 (explaining that state enforcers "are likely to have a better understanding of local conditions than their federal counterparts, simply by virtue of living and working in the state.").

47. *Id.*

48. *See id.* at 752 ("[D]ivergent enforcement practices by various states and a federal agency generate useful information not only about possible policy approaches, but also about possible ways to structure public enforcement."); Jim Rossi, *Dual Constitutions and Constitutional Duels: Separation of Powers and State Implementation of Federally Inspired Regulatory Programs and Standards*, 46 WM. & MARY L. REV. 1343, 1351 (2005) ("States are . . . more likely to experiment in a regulatory approach, trying out mechanisms that would not likely be adopted without experience by Congress or federal regulators. State enforcement . . . encourage[s] experimentation with different approaches and allow[s] federal goals to be tailored to local conditions.").

49. *Id.* at 746; *see also* Bulman-Pozen & Gerken, *supra* note 1, at 1291 (explaining that state involvement may bolster accountability "by offering more access points for individuals who oppose federal policy" given that "they can petition not only the federal government, but also state officials"); Robert A. Mikos, *The Populist Safeguards of Federalism*, 68 OHIO ST. L.J. 1669, 1699–1704 (2007) (surveying evidence that citizens trust their state governments more than the federal government); Rossi, *supra* note 48, at 1350–51 ("[G]iven the reduced cost of political mobilization at the state and local levels, involving states in the regulatory process may increase participation, which can have obvious payoffs for regulatory compliance, legitimacy, and efficiency.").

get that information out—will be hard at work educating voters."[50]

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As this brief overview makes clear, the desirability of concurrent state-federal enforcement is highly indeterminate when discussed in the abstract. The best that can be said at a trans-substantive level is that such regimes can create both significant costs and significant benefits. To get traction on the net effect of concurrent enforcement requires a nuanced appraisal of how it operates within a particular regulatory setting. The next Part seeks to advance our understanding of concurrent state-federal enforcement by identifying several contextual factors that will influence the magnitude of the costs and benefits it potentially produces.

II. THE CONTINGENT CASE FOR CONCURRENT ENFORCEMENT

The recent spate of literature on concurrent state-federal enforcement regimes takes as a starting point that the misconduct targeted is a proper topic of federal interest and views the states' role as fundamentally subordinate to—indeed, in service of—federal regulatory goals. Rachel Barkow, for example, conceptualizes state enforcement as a tool Congress can use to discipline federal administrative agencies.[51] Gillian Metzger's work also treats the "preservation of state authority less as a goal worth pursuing in its own right than instrumentally as an important mechanism for guarding against federal agency failure."[52] Jessica Bulman-Pozen and Heather Gerken go so far as to liken the federal government to "master" and the states to "servants."[53]

To the extent that there are areas of regulation that do not belong in the hands of the federal government—whether as a matter of constitutional mandate or good public policy—the case for concurrent enforcement is obviously mooted. In other

50. Bulman-Pozen & Gerken, *supra* note 1, at 1291.

51. *See generally* Barkow, *supra* note 2.

52. Metzger, *supra* note 42, at 5.

53. Bulman-Pozen & Gerken, *supra* note 1, at 1270; *see also* Gluck, *supra* note 20, at 565 (describing state enforcement of federal law as a potential tool "of national power, a specific strategy used by the federal government to strengthen its new federal laws and the federal norms they introduce").

words, the potential desirability of concurrent enforcement depends on one's answer to first order federalism questions about the propriety of federal involvement in a particular substantive area. Take, for example, corporate law. Those who believe that state competition for corporate charters leads to a "race to the bottom" and thus favor the federalization of corporate law might be persuaded of concurrent enforcement's virtues: allowing states to enforce federal corporate laws or more shareholder-protective state corporate laws might be viewed as a valuable failsafe in the event of federal under-enforcement.[54] But those who believe that competition for corporate charters leads to a "race-to-the-top" will remain opposed to any form of federal intervention in corporate law.[55]

Even if the propriety of federal involvement is conceded, however, a variety of other factors will affect the costs and benefits—and hence ultimately desirability—of concurrent enforcement. These other factors are discussed in general terms below. The next Part will apply this learning to analyze the specific case of securities fraud enforcement against nationally traded firms.

A. THE RATIONALE FOR FEDERAL INVOLVEMENT

As just noted, whether concurrent state-federal enforcement is desirable becomes a relevant question only if it has first been decided that there should be a federal enforcement role. *Why* it has been decided that there should be a federal enforcement role, however, bears significantly on this second order question.

One well-accepted justification for federal intervention in a particular regulatory area sounds in efficiency.[56] If states capture the bulk of both the costs and benefits of regulating a particular activity, then faithful state representatives are likely to adopt policies that maximize social welfare. But if states' efforts create either positive or negative interstate externalities, a case can be made for federal involvement. Consider the enforcement context. States might underenforce when in-state de-

54. *See* Jones, *supra* note 34, at 630–31.

55. *See infra* note 67 (discussing the race-to-the-top argument in corporate law scholarship).

56. My purpose in this section is to discuss some of the most common arguments in favor of federal regulation, and how they relate to the case for concurrent state enforcement. The rationales explored are not meant to constitute an exhaustive list.

fendants have engaged in misconduct that harms out-of-state interests, or more generally when enforcement efforts would create deterrence benefits that would be shared with the entire nation. Conversely, states might overenforce when out-of-state defendants have engaged in activities detrimental to in-state interests.[57] Pursuing marginal cases, using draconian investigative procedures, or pushing for excessive sanctions can reap in-state benefits, while the overdeterrence costs such activities produce are borne by the nation at large. A faithful federal government will have better enforcement incentives in cases involving significant interstate externalities, because unlike the states, it will capture both the costs and benefits of its enforcement decisions. Unlike fragmented state actors, it will also stand in a unique position to craft a coherent enforcement policy concerning matters with an interstate dimension.[58]

Interstate externalities are not the only efficiency-based justification for federal intervention. A distinct, and more contested, justification is to prevent a "race to the bottom."[59] A race to the bottom is said to develop when state competition to attract mobile industries, and the jobs and tax revenue they generate, causes states to adopt laxer regulations (or enforcement policies) than they would in the absence of competition, leading

57. To underenforce and overenforce in this context should not be understood to refer narrowly to the quantity of cases brought. Instead, the focus is case *quality*—states may under-enforce by bringing too few "good" cases and at the same time over-enforce by bringing "bad" ones. *Cf.* James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Laws*, 100 CAL. L. REV. 115, 128–29 (2012) (criticizing economic theories of enforcement for focusing on quantitative rather than qualitative measures of enforcement output).

58. For the seminal work articulating this rational for federal regulation, see generally OATES, *supra* note 9. For a more recent discussion, see Robert D. Cooter & Neil S. Siegel, *Collective Action Federalism: A General Theory of Article I, Section 8*, 63 STAN. L. REV. 115, 135–44 (2010). *See also* Samuel Issacharoff & Catherine M. Sharkey, *Backdoor Federalization*, 53 UCLA L. REV. 1353, 1387 (2005–06) ("[S]tate officials could well respond to the political preferences of the voters of any particular state yielding 'intrajurisdictional efficiency' at the expense of the 'interjurisdictional efficiency' concerns of the polity writ large. The end result could be underregulation or overregulation." (citations omitted)).

59. This rationale for federal intervention is sometimes alternatively described as preventing a tragedy of the commons, *see, e.g.*, Richard B. Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 YALE L.J. 1196, 1211–12 (1977), or as solving a prisoner's dilemma, *see, e.g.*, Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210, 1217–18 (1992).

to net social welfare losses.[60] This can occur even if states fully internalize the costs and benefits of their regulatory choices.[61] In race-to-the-bottom scenarios, federal "floor" regulation is viewed as a way to halt the downward spiral.[62] As noted, this is a contested justification for federal intervention; some scholars dispute the claim that state competition leads to inefficient outcomes, or that federal floor regulation will necessarily increase social welfare.[63]

Race-to-the-bottom concerns have animated many federal environmental laws, such as provisions in the Clean Air Act.[64] Some federal environmental laws more directly address problems of interstate externalities,[65] as do many federal laws focused on the national marketplace.[66] Although the corporate law debate is typically discussed in race-to-the-bottom terms, it is really about interstate externalities, specifically, whether states fully consider the impact of their choices on out-of-state shareholders in crafting their corporate laws.[67]

60. For a fuller exposition of the race-to-the-bottom phenomenon, and the assumptions underlying the phenomenon, see Revesz, *supra* note 59*,* at 1213–21.

61. *See id*. at 1222–23 (distinguishing the race-to-the-bottom rationale for federal intervention from the interstate externality rationale).

62. *See generally* William W. Buzbee, *Asymmetrical Regulation: Risk, Preemption, and the Floor/Ceiling Distinction*, 82 N.Y.U. L. REV. 1547, 1586–87 (2007) (defending federal floor preemption as a way to deal with the race-to-the-bottom phenomenon).

63. *See generally* Revesz, *supra* note 59, at 1244–47 (arguing that even if there were a race to the bottom in the environmental arena, federal environmental regulation could have undesirable effects); *see also* Kirsten H. Engel, *State Environmental Standard-Setting: Is There a "Race" and Is It "To the Bottom"?*, 48 HASTINGS L.J. 271, 297–315 (1996–97) (exploring the debate over whether interstate competition reduces or enhances social welfare).

64. *See* Revesz, *supra* note 59, at 1224–26 (arguing that the bulk of the Clean Air Act was justified by the race-to-the-bottom rationale).

65. *See, e.g.*, *id.* (noting that there were some aspects of the Clean Air Act—such as the provision limiting the amount of pollution from upwind states permitted to affect air quality in downwind states—directed at interstate externalities).

66. *See, e.g.*, *infra* Part III (positing that federal securities regulation is a response to concerns about interstate externalities).

67. *See* Revesz, *supra* note 59, at 1247 (noting that "[t]he legal literature has included under the race-to-the-bottom rubric a variety of problems that are analytically distinct . . . [such as] the problem of state chartering of corporations"). The dominant scholarly argument in favor of the federalization of corporate law is premised on the belief that managers in diffusely held public corporations can get away with making incorporation decisions that favor management at the expense of the shareholders. States respond to this reality, the argument goes, by crafting their corporate codes to cater to management,

Other justifications for federal intervention exist that are not grounded in notions of efficiency. For example, even in the absence of interstate externalities or race-to-the-bottom concerns, federal intervention may be warranted to protect federally recognized rights that are viewed as critical to national identity. Federal laws prohibiting discrimination might be justified in this way,[68] as might federal laws protecting religious freedom and freedom of speech, among other American values.[69]

When the reason for a particular federal law is to prevent a race to the bottom, or to protect a base level of national rights, and interstate externalities are not a serious concern, the case for preserving a state's enforcement role is apparent. In such a scenario, if states were more aggressive in their enforcement of federal law than the federal government itself, or chose to provide greater protection to their citizens under state law, it would not result in a "policy distortion," in the proper sense of the term. Rather, it would reflect legitimate state policies that truly come, in the famous words of Justice Brandeis, "without risk to the rest of the country."[70] The costs and benefits of those policies would be felt primarily within the respective states, and federal policy goals would be respected. Moreover, accountability concerns would be less pressing; it should be fairly easy for citizens to understand that the federal government has set a floor, and deviations above that floor are each state's responsibility. Of course, even in this context concurrent enforcement is not costless. It could result in duplicative enforcement efforts and added expense, among other things. But the cost side of the

as doing so earns them franchise tax revenue and other benefits while the costs are mostly borne by out-of-state shareholders. This is problematic from a social welfare perspective, because as residual claimants, shareholders are thought to have the best incentives to maximize firm value. Those who oppose the federalization of corporate law, by contrast, believe that market forces keep managers faithful to shareholders, and thus that states have incentives to adopt corporate laws that cater to shareholders and, as a result, efficiently maximize the size of the corporate pie. For the classic arguments on each side of this debate, see William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974), and Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 290 (1977).

68. *See, e.g.*, DAVID L. SHAPIRO, FEDERALISM: A DIALOGUE 53–54 (1995) (arguing a strong national authority was necessary to protect the rights of minorities from institutionalized racism at the state level following the Civil War).

69. Some view environmental regulation in this way. *See, e.g.*, Engel, *supra* note 63, at 288–92 (discussing the "environmental rights" argument).

70. *See supra* note 13 and accompanying text.

ledger is fairly light, and the case for allowing states to provide tailored protections to their own citizens is compelling.

When federal intervention is warranted as a way to deal with interstate externalities, by contrast, the wisdom of concurrent state enforcement is more difficult to establish. If the risk of over-enforcement at the state level is the reason for federal intervention, then maintaining concurrent state enforcement—as opposed to preempting any state role—would be counterproductive, at least absent some level of federal control to prevent abusive state enforcement and ensure federal policy goals are actualized. If the risk justifying federal involvement is state-level under-enforcement, preserving a state role may be desirable. Federal enforcers may, after all, themselves under-enforce, such that supplemental state enforcement—even if predictably limited—may help push toward optimal levels, as well as provide the additional benefits associated with a concurrent state role. But this still loosens the federal government's control over policy outcomes, and introduces added expense and a potential loss of democratic accountability. If, more realistically, there is a risk of both under- and over-enforcement at the state level (i.e., too few "good" cases and too many "bad" ones),[71] the calculus becomes most complex. Will the reduction in under-enforcement costs concurrent state enforcement promises outweigh the over-enforcement and other costs it risks producing? This is the most challenging question policymakers must face, and it is fundamentally empirical in nature.

The remainder of this Part assumes a scenario where the purpose of the federal intervention is to deal with interstate externalities. As explained above, this is the context that raises by far the most serious questions about the desirability of concurrent state enforcement. Moreover, cooperative and competitive federalists alike recognize the presence of interstate externalities to be a valid reason for federal regulation,[72] although in particular regulatory contexts there may be empirical disagreement over whether significant interstate externalities actually exist.[73] This assumption thus allows us to avoid contentious first order federalism questions that too often muddy discussions of optimal enforcement design.

71. *See supra* note 57.

72. *See, e.g.*, CHEMERINSKY, *supra* note 1, at 119 ("National action often may be desirable to prevent spillovers and externalities.").

73. The corporate law context is one where such disagreement exists. *See supra* note 67.

B. STRUCTURAL FEATURES OF THE CONCURRENT ENFORCEMENT REGIME

Several structural features of a concurrent enforcement regime will also influence the magnitude of the costs and benefits it produces. Unlike the rationale for federal involvement, which may be subject to dispute, these features are easily observable.

1. The Substantive Prohibition

The importance of enforcement discretion to policy outcomes is contextually dependent. It is most critical when the law is vague or overbroad, leaving regulated parties looking to prosecutors and courts for clues on how to comply.[74] If the law identifies the behavior to be proscribed with specificity, and the risk of legal error and misguided prosecution is low (which is likely to be the case with a very specific law), unleashing multiple enforcers is less worrisome. Regulated parties can avoid sanction with confidence, and the possibility of policy distortion through enforcement discretion is low.[75] In other words, because the risk of over deterrence is low, state enforcement is unlikely to produce significant negative interstate externalities.[76] Thus, whether the misconduct is proscribed in terms of clear rules or vague standards is important in determining the potential costs of a concurrent state-federal enforcement regime.[77]

74. *See* Lemos, *supra* note 2, at 759 ("Concerns about disuniformity recede when states are called upon to enforce a relatively precise federal statute or regulation." (footnote omitted)).

75. There are, of course, a variety of other factors that influence the choice between rules and standards. *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

76. This is not to say that the risk of policy distortion and over deterrence would be nonexistent. If firms are held vicariously liable for their employees' actions, they might not be able to avoid liability with confidence despite the law's specificity, and concurrent enforcement might undesirably ratchet up expected sanctions. This may lead firms to over-invest in internal deterrence measures. *See* Rose, *supra* note 24, at 2187.

77. Professor Bulman-Pozen similarly observes that "the broader the delegation [of authority to a federal agency], or the more ambiguous the statute, the more room there may be for states to contest federal executive power." Bulman-Pozen, *supra* note 36, at 487. But she views this as a benefit, based on two key assumptions: (1) the federal executive is likely to deviate from congressional wishes when given such an open-ended grant of authority, and (2) state enforcement efforts will operate to check this tendency in desirable ways. I discuss federal and state enforcement behavior separately below. *See infra* Part II.C–D.

2. State Enforcement of Federal vs. State Law

Concurrent enforcement, as that term is used in this Article, comes in two varieties. First, states may be granted authority to enforce *federal* laws that are also enforced by federal agencies. For example, state attorneys general are explicitly authorized to enforce a variety of federal antitrust and consumer protection laws.[78] Second, states may enforce *state* laws that target the same type of misconduct as federal laws enforceable by federal agencies. For example, states can also enforce their own antitrust and consumer protection laws in situations where federal enforcers could target the same type of misconduct under federal law.

This second variety of concurrent enforcement is most prevalent, as it catches a multitude of areas where Congress has chosen to legislate without preempting state law. It also presents greater potential costs in terms of federal policy distortion, because it allows for greater state level deviation from federal policy goals (assuming, importantly, that the relevant state laws are not restricted to primarily intrastate activities).[79] Indeed, it would allow for such deviation even in cases where the federal rule is fairly well defined. This in turn creates higher expense for regulated parties, in the form of monitoring and compliance costs, and heightens the democratic accountability concerns that flow from states' ability to affect policy outcomes outside their borders. Unlike state enforcement of federal law, however, it does not interfere with state level separation of powers arrangements. It also means that state enforcement will affect only the development of state doctrine, rather than influencing the very meaning of federal law.[80]

The benefits of this variety of concurrent enforcement relative to state enforcement of federal law are uncertain. States have a greater ability to tailor and innovate when state law is

78. *See* Widman & Cox, *supra* note 2, at 56–57 (discussing the explicit grants of state enforcement authority in federal laws, including the Clayton Act, the Nutrition Labeling Act, the Telephone Consumer Protection Act, Consumer Credit Reporting Reform Act of 1996, and the Health Insurance Portability and Accountability Act).

79. *See* Lemos, *supra* note 2, at 760 ("If socially valuable activity will be deterred by overly aggressive enforcement, state enforcement of federal law seems significantly less threatening than states' ability to create and enforce legal standards that are stricter than the federal model.").

80. *Cf. id*. at 740 ("State enforcement [of federal law] may change federal 'law in the books' by generating judicial decisions that clarify the scope of the law.").

their instrument, but one can question whether substantive tailoring and innovation is desirable when federal intervention is meant to address interstate externalities. Citizens also have more influence over the development of state law, but if such influence produces out-of-state effects it comes at a democratic cost. Most importantly, when states keep control over the law itself, rather than just enforcement, the potential for states to check federal agency under-enforcement due to capture may be greater. This assumes, however, that the federal enforcement agency has control over the *content* of federal law. For example, if captured federal agencies can engage in rulemaking that undesirably restricts the scope of federal law, state enforcement of state law can serve as a counterweight whereas state enforcement of federal law could not. But the marginal benefits of this sort of check are likely less than the marginal benefits of preserving just an enforcement role. This is because the failure to bring an enforcement action is not subject to any form of judicial review, heightening capture concerns.[81] Rulemaking, by contrast, is subject to judicial review, as well as notice and comment procedures.[82]

3. Number of States with Concurrent Jurisdiction

In some regulatory areas concurrent state-federal enforcement authority means that the federal government and a single state will share jurisdiction over particular misconduct. The number of states with jurisdiction may be singular because the conduct is intrastate in nature, which as previously explained makes an easy case for concurrent state enforcement (though a more contestable case for federal intervention in the first in-

81. *See* Lisa Schultz Bressman, *Judicial Review of Agency Inaction: An Arbitrariness Approach*, 79 N.Y.U. L. REV. 1657, 1664–75 (2004) (explaining how both the doctrines of nonreviewability and standing operate to "prohibit parties from challenging, and courts from examining, agency refusals to initiate enforcement proceedings"); *see also* Amy Widman, *Advancing Federalism Concerns in Administrative Law Through a Revitalization of State Enforcement Powers: A Case Study of the Consumer Product Safety and Improvement Act of 2008*, 29 YALE L. & POL'Y REV. 165, 190 (2010) (observing that state enforcement is particularly important given these doctrines).

82. Administrative Procedure Act, 5 U.S.C. §§ 701–706 (2012) (providing an overview of judicial review as related to federal rulemaking). States may have an easier time establishing standing to challenge federal agency decisions than private parties. Metzger, *supra* note 42, at 40–41. If the concern were *congressional* capture, then the case for retaining state law would be stronger. But the recent literature views concurrent state enforcement as a tool Congress uses to check capture at agencies dominated by the executive branch. *See, e.g.*, *supra* note 51 and accompanying text.

stance).[83] But it is also possible when interstate externalities justify a federal enforcement role. For example, as explained above, some believe that state corporate law generates interstate externalities that warrant federal intervention. If a federal corporate code were enacted while preserving more "shareholder-friendly" state laws, only a single state would have concurrent jurisdiction because the internal affairs doctrine allows firms to opt exclusively into the corporate laws of a single state. It could also be the case in other areas where the nature of the regulated conduct and jurisdictional rules work in practice to expose regulated parties to the authority of only a single state, in addition to the federal government. Various gun and drug crimes might be examples. In other situations, however, concurrent enforcement authority exposes regulated parties to prosecution for the same misconduct by the federal government and the governments of more than one—and potentially all fifty—states. Firms engaged in interstate commerce, for example, may expose themselves to antitrust liability on such a scale by virtue of their national operations.[84]

This distinction bears on the magnitude of a variety of costs and benefits typically associated with concurrent enforcement. On the cost side, the expense of a concurrent enforcement regime will rise with the number of states with jurisdiction. There will be more governments monitoring for the same misconduct, and the potential for duplicative, uncoordi-

83. *See supra* Part II.A.

84. A mature debate exists over the wisdom of concurrent state enforcement in the antitrust context. *See, e.g.*, Stephen Calkins, *Perspectives on State and Federal Antitrust Enforcement*, 53 DUKE L.J. 673 (2004) (defending concurrent state enforcement); Carole R. Doris, *Another View on State Antitrust Enforcement—A Reply to Judge Posner*, 69 ANTITRUST L.J. 345 (2001) (same); Harry First, *Delivering Remedies: The Role of the States in Antitrust Enforcement*, 69 GEO. WASH. L. REV. 1004 (2001) (same); Robert L. Hubbard & James Yoon, *How the Antitrust Modernization Commission Should View State Antitrust Enforcement*, 17 LOY. CONSUMER L. REV. 497 (2005) (same); *cf.* Richard A. Posner, *Federalism and the Enforcement of Antitrust Laws by State Attorneys General*, *in* COMPETITION LAWS IN CONFLICT: ANTITRUST JURISDICTION IN THE GLOBAL ECONOMY 252–66 (Richard A. Epstein & Michael S. Greve eds., 2004) [hereinafter COMPETITION LAWS IN CONFLICT] (criticizing concurrent state enforcement); Michael L. Denger & D. Jarrett Arp, *Does Our Multifaceted Enforcement System Promote Sound Competition Policy?*, 15 ANTITRUST 41 (2001) (same); Robert W. Hahn & Anne Layne-Farrar, *Federalism in Antitrust*, 26 HARV. J.L. & PUB. POL'Y 877 (2003); Posner, *supra* note 22 (same). For more information about this debate, see also Michael DeBow, *State Antitrust Enforcement: Empirical Evidence and a Modest Reform Proposal*, *in* COMPETITION LAWS IN CONFLICT, at 267–88; Michael S. Greve, *Cartel Federalism? Antitrust Enforcement by State Attorneys General,* 72 U. CHI. L. REV. 99 (2005).

nated investigations and lawsuits will increase, along with regulated parties' monitoring and compliance costs. There will also be a greater risk of policy distortion. A large number of states with jurisdiction suggests a low likelihood each individual state will internalize a significant portion of the over-deterrence costs produced by bringing opportunistic enforcement actions. Moreover, a collective action dynamic might lead states to bring those sorts of actions when they otherwise would not, on the rationale that if they do not another state likely will. The same collective action dynamic might weaken the threat of federal preemption as a disciplining device, to the extent it operates as one.[85] Finally, the difficulty of deciphering just who is responsible for policy outcomes increases with the number of enforcers, heightening democratic accountability concerns.

That said, the primary benefit of concurrent enforcement—its ability to counter lax federal enforcement—likely increases with the number of enforcers. It is easier for parties interested in under-enforcement to capture federal regulators and a single state than federal regulators and multiple states. If multiple states have jurisdiction, it also increases the aggregate enforcement resources available. It should be noted, however, that having a multiplicity of enforcers can also cut the other way by creating a free-rider problem, as each state might prefer another to incur the costs of enforcement.

4. Safeguards

When Congress has affirmatively created a concurrent state-federal enforcement regime—as opposed to passively creating one by legislating without preempting analogous state laws—it has often included provisions in the legislation that help to mitigate the potential for state enforcement efforts to create redundant expense or to distort national policy goals. For example, advance notice requirements are common; these facilitate dialogue and discourage duplication of effort by requiring a state enforcer to notify the relevant federal enforcement agency of its plan to initiate an action.[86] In addition, state enforcement is sometimes barred if a related federal action is

85. *See supra* note 38 and accompanying text.

86. Lemos, *supra* note 2, at 708. This sort of notice requirement can also assist Congress in monitoring the federal enforcement agency, by drawing attention to cases that it has chosen not to pursue. *Cf.* Bulman-Pozen, *supra* note 36, at 498 (explaining how state regulators "can make Congress more likely to pay attention, to have the information it needs, and to be motivated to correct the administration of federal law").

pending, and federal agencies are sometimes given a right to intervene in state enforcement actions, thus allowing them to assert more direct influence over the proceedings.[87] Federal legislation sometimes requires suits to be brought exclusively in federal court, promoting consistency in the interpretation of concurrently enforced legal rules.[88] Federal legislation also sometimes limits the type of remedies that state enforcers can pursue, cabining their ability to influence the behavior of regulated parties through the threat of sanctions.[89] Finally, federal legislation sometimes regulates states' use of private counsel, which may skew state enforcement incentives. In some cases it has barred contingency-fee arrangements with private counsel; in others it has limited the ability of private counsel to exploit information they obtain in state representations for personal benefit.[90] The presence, or absence, of these various design features is clearly relevant in assessing the costs of a particular concurrent enforcement regime.

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In some cases, a review of the foregoing structural factors may make clear that concurrent state enforcement is unlikely to create significant costs, and the analysis might properly end here. In other cases, however, these factors may suggest that concurrent enforcement has the potential to be quite costly, necessitating a closer examination of federal and state enforcement behavior to determine if those costs are likely outweighed by concurrent enforcement's benefits.

C. THE FEDERAL ENFORCER

The benefit of concurrent state-federal enforcement most stressed in the literature is its ability to protect against lax federal enforcement. But all federal enforcement agencies are not created equal. Some might, in fact, under-enforce if granted an enforcement monopoly—but others might enforce at optimal

87. Widman & Cox, *supra* note 2, at 61.

88. *See, e.g.*, Lemos, *supra* note 2, at 760 ("When state enforcement is confined to federal court—and particularly when it is linked to agency regulations—the possibility that state enforcers will target behavior that federal policy makers have condoned is significantly reduced."); Widman & Cox, *supra* note 2, at 61.

89. Widman & Cox, *supra* note 2, at 62.

90. *Id.* at 63.

levels, or even over-enforce. The political economy in which the relevant agency operates must be carefully examined before a judgment can be reached about the need for state enforcement as a check on federal enforcement laxity. Will the regulated parties who exert influence on the agency prefer under-enforcement? What sway do competing interest groups have over agency enforcement policy? Does agency culture influence its enforcement behavior independently of interest group pressure, and if so what impact does it have? Do other administrative law checks effectively insulate the agency from capture?[91] If not, could they be implemented at less cost than concurrent state enforcement? What is, in fact, the agency's enforcement track record? All of these questions must be considered before it can be concluded that concurrent enforcement is necessary to remedy federal under-enforcement.

It should be noted that whether a federal agency "under-enforces" in a particular area will often be a contested issue. But if there is a shared understanding as to the federal law's purpose, such disputes will turn on empirical rather than normative questions. What if there is unresolvable empirical uncertainty as to how much, or what type of, enforcement is needed to achieve a shared policy goal? In such cases, deference should be afforded to the opinion of the current administration—those who lost the political fight for the White House cannot credibly claim that an agency is "under-enforcing" simply because they have a different intuition as to the best enforcement approach.

D. THE STATE ENFORCER(S)

An under-studied, yet hugely important, variable affecting the desirability of concurrent state-federal enforcement is how exactly states will use their enforcement authority. An array of possibilities exist. For example, as explained in Part II.A, a state may bring enforcement actions that are profitable for it even when they do not create net social benefits. If a state can impose a large fine on an out-of-state defendant at little cost to itself, it is in its selfish interest to do so even if such behavior imposes negative externalities on the rest of the country in the form of over-deterrence costs. We might call this the "Rent Seeking Hypothesis." If true, it suggests that concurrent state enforcement is socially undesirable.

91. For a good review of the options, see Barkow, *supra* note 2.

Traditional theories of cooperative federalism suggest an alternative possibility: State enforcers might work together with federal enforcers, efficiently sharing the enforcement burden.[92] For example, a federal enforcer might take the enforcement lead when it enjoys a comparative enforcement advantage relative to a state enforcer (such as a better ability to investigate crimes with a multistate dimension), and a state enforcer might step in when it has an advantage over the federal enforcer (such as when most of the witnesses and evidence are located within the state). We might call this the "Cooperation Hypothesis." If this hypothesis is true, it suggests that concurrent state enforcement is socially beneficial.

The Cooperation Hypothesis stands in tension with recent literature on concurrent state enforcement, however, as it seems to assume public-spiritedness on the part of regulators at both layers of government. This recent literature assumes, by contrast, that federal enforcement agencies will systematically under-enforce, due to capture or other bureaucratic pathologies, and views state enforcement as a potential corrective.[93] We might call this the "Vacuum Filling Hypothesis," as it reflects the notion that state enforcers will act to fill federal enforcement gaps. But if the Cooperation Hypothesis stands in tension with the Vacuum Filling Hypothesis, the Vacuum Filling Hypothesis stands in tension with itself. Is it logical to assume that states will act in a national-regarding way, while simultaneously assuming federal enforcers will not? Are state enforcers uniquely immune from the selfish impulses public choice theory ascribes to government actors?

One possible response to this critique is that state enforcers are more accountable to the electorate than federal agencies, and thus less subject to capture by industry. But this may not be the case in every regulatory context, or in every state.[94] As with determining the likelihood of federal under-

92. *See* Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and "Dual Sovereignty" Doesn't*, 96 MICH. L. REV. 813, 815 (1998) ("[I]ndependent governments work[] together to implement federal policy.").

93. *See supra* note 2 and accompanying text.

94. For example, only 36% of state securities enforcers are elected. *See infra* note 223 and accompanying text. *See also* Jill E. Fisch, *Institutional Competition to Regulate Corporations: A Comment on Macey*, 55 CASE W. RES. L. REV. 617, 624 (2005) (observing that "[i]t should virtually always be easier for an industry, such as the financial services industry, to capture the state level of regulation than to capture the Congress and the SEC").

enforcement, a detailed appraisal of the political economy in which state enforcers operate is necessary before conclusions can be reached about state enforcement behavior. A related argument is that the increased difficulty of capturing multiple enforcers alone makes capture less likely. But this argument works only for interest groups desiring *less* enforcement. Those who favor excessive enforcement need capture only one to succeed, and the existence of multiple enforcers to choose from makes that easier to do. Which interests groups would favor excessive enforcement? Again, the answer is necessarily context specific. In some regulatory areas, it might be none, alleviating this concern. In others, it might be the trial bar, if the state collaborates with private counsel in its enforcement efforts. Firms might also favor opportunistic state litigation if targeted at competitors. It is necessary to weigh the increased potential for capture-induced over-deterrence against the decreased potential for capture-induced under-deterrence when evaluating the net impact of concurrent state enforcement.

Even if it is true that state enforcers are less subject to capture than their federal counterparts, it would seemingly ensure only that state enforcers acted to promote their particular state's welfare, whereas the Vacuum Filling Hypothesis assumes they will act to advance the *national* welfare. And recall that when federal intervention is warranted due to interstate externalities, states' interests will never align perfectly with national interests. That said, in some situations particular states may have enough to gain by filling a federal enforcement vacuum that they may be willing to incur the costs of doing so, even though they cannot fully internalize the benefits of their actions.[95]

As with the Cooperation Hypothesis, the Vacuum Filling Hypothesis suggests that concurrent state enforcement plays a socially useful function. But a word of caution is in order: State enforcers might be wrong, even if well-intentioned. They (or the electorates they represent) may misinterpret a reasoned exercise of discretionary non-enforcement at the federal level as a "vacuum" that needs filling. Good policy reasons exist for put-

95. It might also be the case that state electorates are more other-regarding than rational actor models predict. If so, perhaps they can be counted on to sublimate their state's parochial interests and support enforcement policies that they believe are in the national interest. Of course, if states really could be counted on to behave this way, it would undermine the case for a federal enforcement role. *See supra* Part II.A.

ting enforcement decisions into the hands of expert agencies, and insulating them from day-to-day political pressures. Most notably, some types of misconduct rouse populist sentiment that might lead elected, generalist state enforcers to pursue enforcement policies that are not in the nation's long-term best interest.[96]

The idea that politics may drive state enforcement decisions gives rise to a fourth hypothesis, one we might label the "Political Entrepreneur Hypothesis." This hypothesis, which is consistent with public choice accounts of regulatory behavior, posits that state enforcement decisions are driven as much by the individuals making them as by considerations of state or national welfare. For example, politically ambitious state regulators may exercise their concurrent enforcement authority in order to reward campaign donors or to gain publicity, which can aid in future electability. Unlike the other three, this hypothesis, if true, does not speak directly to the social value of concurrent state enforcement. Political ambition may lead state regulators to exercise their enforcement authority in socially detrimental ways, or it may lead them to act in ways that promote the nation's best interests. The latter is more likely if the regulator is beholden to a constituency that is both concerned with and knowledgeable about the impact of the regulator's enforcement choices on national welfare. It is less likely if the regulator is beholden to a constituency that favors the states' parochial interests, or which suffers from behavioral biases that lead it to favor enforcement without considering the less salient costs of regulatory action.[97]

The point of this discussion is not to claim that states will behave in any particular way, but simply to demonstrate that predicting how states will use their enforcement authority is extremely complex—and yet critical to any informed evaluation of the net benefits of a concurrent state-federal enforcement re-

96. *See* Barkow, *supra* note 2, at 19–21 (explaining the idea that agencies should be "insulated from short-term political pressures so that [they can] adopt public policies based on expertise that would yield better public policy over the long term"); Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 613 (2010) ("Perhaps the most powerful justification for committing certain decisions to independent agencies was that officials within such agencies would make difficult yet ultimately beneficial decisions that politicians would not.").

97. *See*, *e.g.*, A.C. Pritchard, *The SEC at 70: Time for Retirement?*, 80 NOTRE DAME L. REV. 1073, 1080 (2005) (explaining how "[o]pportunistic politicians may take advantage of the biases of the electorate, playing up recent instances of fraud to gain electoral support").

gime. Each of the hypotheses introduced above could be evaluated empirically in concrete regulatory settings to get a better sense of what actually motivates state enforcement behavior—and what it means for the value of concurrent enforcement. The case study that follows does just that in the securities fraud context.

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This Part has demonstrated that the desirably of concurrent state-federal enforcement in a particular regulatory area is highly contingent on a variety of factors. A sophisticated appreciation of the regulatory context is therefore necessary before such a judgment can be made, as is an empirically-grounded understanding of how both the relevant federal and state enforcers use their enforcement authority. What follows is a case study of concurrent state-federal enforcement in the securities fraud context that seeks to follow this advice.

III. A CASE STUDY OF CONCURRENT SECURITIES FRAUD ENFORCEMENT AGAINST NATIONALLY TRADED FIRMS

Numerous scholars have observed that case studies are needed to better appreciate how concurrent state-federal enforcement regimes fare in real world policy settings.[98] Part II provides the tools needed to conduct such a case study in a principled way. This Part now applies those tools to evaluate the concurrent state-federal securities fraud enforcement regime. This regime is a particularly good candidate for evaluation, as the wisdom of the United States' multi-enforcer approach to securities fraud deterrence has come under considerable fire in recent years.[99] Most of the scholarly atten-

98. *See supra* note 12 and accompanying text.

99. *See generally* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69 (2011) (arguing that fraud-on-the-market securities class actions should be eliminated and replaced with stepped-up public enforcement efforts); John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229 (2007) (suggesting that flaws in private securities enforcement may warrant increased reliance on public enforcement); Jessica M. Erickson, *Overlitigating Corporate Fraud: An Empirical Examination*, 97 IOWA L. REV. 49 (2011) (arguing for more targeted deterrence of corporate fraud); Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 207 (2009) (questioning the effectiveness of private enforcement

tion has been focused on the overlap between SEC and class action enforcement, however, leaving the allocation of enforcement authority as between the states and the federal government understudied.

Part III.A provides a quick background on the development of this particular concurrent enforcement regime, and the significant controversy it has engendered. Part III.B then analyzes its potential costs and benefits by reference to the contextual factors identified in Part II. The case study is continued in Part IV, which reports on empirical findings concerning the enforcement behavior of state securities regulators vis-à-vis nationally traded firms.

A. BACKGROUND

The federal government did not enter the business of securities regulation until the 1930s. When it did so, under-regulation and under-enforcement at the state level was the animating concern.[100] Specifically, the New Deal Congress believed that state securities laws—known as "Blue Sky Laws"—had been ineffective in deterring abuses that contributed to the Stock Market Crash of 1929 and the ensuing Great Depression.[101] Thus, both the Securities Act of 1933 (which regulates the primary offering of securities) and the Securities Exchange Act of 1934 (which, among other things, creates ongoing periodic disclosure obligations for firms that have gone "public") supplemented but did not displace state securities laws.[102] For the next sixty-plus years, federal regulation of securities offerings,

relative to public enforcement); Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301 (2008) (arguing that SEC oversight of securities class actions would lead to efficiency gains); Rose, *supra* note 24 (questioning whether the preconditions for efficient use of multiple securities law enforcers exist in the United States); *see also* COMM. ON CAPITAL MKTS. REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 9–10, 68–69 (Nov. 30, 2006), http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf (encouraging greater coordination between state and federal securities regulators).

100. *See* James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (describing the motivation of Congress in implementing securities litigation).

101. For a critical history of state securities regulation, see Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347 (1991).

102. Securities Act of 1933, 15 U.S.C. §§ 77a–77bbbb (2006); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78pp (2006).

mandatory corporate disclosure, and securities fraud existed concurrently with state regulation.

This changed in 1996 when Congress enacted the National Securities Markets Improvement Act (NSMIA).[103] At that moment in history, over-regulation and its impact on the competitiveness of our national capital markets was the primary concern in Congress.[104] In connection with NSMIA's adoption, the Committee of Conference described concurrent state-federal securities regulation as "redundant, costly, and ineffective," and noted testimony that it "tends to raise the cost of capital to American issuers of securities without providing commensurate protection to investors or to our markets."[105] NSMIA thus sought "to firmly ensconce the SEC as 'the exclusive regulator of national offerings of securities.'"[106] To achieve this, NSMIA broadly preempted state authority to regulate the offering of "covered securities"—which include securities traded on national exchanges—as well as the ongoing disclosure obligations of the firms issuing them.[107] NSMIA expressly preserved, however, the authority of state securities commissions (or like state agencies) to bring enforcement actions with respect to fraud or deceit.[108] In 1998 Congress preempted securities class actions brought under state law against nationally traded firms, but again expressly preserved the authority of state regulators to pursue these firms for fraud or deceit.[109] Thus, while states today cannot apply their own ex ante mandatory disclosure and offering rules to nationally traded firms, state regulators can use their own fraud rules to police those firms' disclosures ex post.

The wisdom of preserving a concurrent state securities fraud enforcement role vis-à-vis nationally traded firms has been hotly debated for over a decade now.[110] Eliot Spitzer is

103. Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.) (1996).

104. *See* H.R. REP. NO. 104-864, at 39–40 (1996).

105. *Id.* at 39.

106. Jonathan R. Macey, *Wall Street in Turmoil: State-Federal Relations Post-Eliot Spitzer*, 70 BROOK. L. REV. 117, 124 (quoting H.R. REP. NO. 104-622, at 16 (1996)).

107. 15 U.S.C. § 77r.

108. *Id.* § 77r(c).

109. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

110. For a recent overview of the debate, see Park, *supra* note 57, at 120–28.

largely responsible for this. It was NSMIA's fraud carve-out that allowed him to bring high-profile enforcement actions to remedy Wall Street abuses during his tenure as New York Attorney General (NYAG). Spitzer utilized his preserved authority to bring numerous actions against nationally traded companies pursuant to New York's turbo-charged Martin Act.[111] For example, Spitzer pursued major brokerage houses for allegedly producing biased analyst research.[112] He also pursued several major mutual fund advisors for permitting favored fund investors to engage in late trading and market timing, undisclosed practices that worked to dilute the returns of longer-term investors.[113] Some lauded Spitzer's actions as promoting the goal of optimal deterrence at a time when the SEC was asleep at the switch; others criticized his actions as politically motivated and ultimately harmful to our capital markets.[114] The NYAG's office continues to make controversial enforcement decisions,[115] provoking calls for reform by industry groups.[116]

111. The Martin Act grants the New York Attorney General broad powers to investigate securities fraud. *See* N.Y. GEN. BUS. LAW § 352 (Consol. 2012); N.Y. EXEC. LAW § 63(12) (Consol. 2012). Prosecutions under the Act require no showing of scienter or intent to defraud, and its use of the terms "fraud" and "fraudulent practice" is read to "include all deceitful practices contrary to the plain rules of common honesty." People v. Cadplaz Sponsors, Inc., 330 N.Y.S.2d 430, 432 (N.Y. Sup. Ct. 1972).

112. John Cassidy, *How Eliot Spitzer Humbled Wall Street*, NEW YORKER, Apr. 7, 2003, at 55.

113. John C. Coffee, Jr., *The Spitzer Legacy and the Cuomo Future*, 329 N.Y. L.J. 5, 5 (2008).

114. *See* Eric Zitzewitz, An Eliot Effect? Prosecutorial Discretion in Mutual Fund Settlement Negotiations, 2003-7, at 2–3 nn.1–3 (Jan. 2008) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1091035. Some were especially critical of Spitzer's apparent effort to make structural changes to the financial markets through his settlements with defendants. *See infra* note 244. Spitzer's actions were so controversial they prompted what became known as the "anti-Spitzer amendment" to the Securities Fraud Deterrence and Investor Restitution Act of 2003, H.R. 2179, 108th Cong. (2003). The amendment would have limited state enforcement authority. *See* Johnathan Mathiesen, *Dr. Spitzlove, or: How I Learned to Stop Worrying and Love "Balkanization"*, 2006 COLUM. BUS. L. REV. 311, 316 (2006) (discussing the demise of this legislation).

115. *See, e.g.*, Coffee, *supra* note 113, at 5; Amir Efrati et al., *Prosecutors Widen Probes into Subprime*, WALL ST. J., Feb. 8, 2008, at C1; Kara Scannell & Dan Fitzpatrick, *SEC Clashes with Cuomo over Firing in BofA Case*, WALL ST. J., Feb. 18, 2010, at C1.

116. *See, e.g.*, Robert A. McTamaney, *New York's Martin Act: Preemption Delayed Is Justice Denied*, LEGAL BACKGROUNDER 1, 1–3 (2011); *see also* Reed

B. ANALYSIS

As discussed below, both the rationale for federal involvement and each of the structural factors identified in Part II.B—the breadth of the substantive prohibition, whether states are enforcing federal law or analogous state laws, the number of states with overlapping jurisdiction, and the presence (or, in this case, absence) of safeguards—suggest that concurrent state-federal securities fraud enforcement against nationally traded firms has the potential to be quite costly. Evaluating the actual enforcement behavior of federal and state securities regulators is therefore key to determining concurrent enforcement's net impact. But these factors are harder to judge. Scholars take divergent views on the efficacy of the SEC, and this Article does not attempt to resolve that debate. As for state enforcement, there has been a marked lack of empirical data on which to assess its contribution to securities fraud deterrence. The next Part begins to fill that void.

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As explained in Part II.A, when analyzing the desirability of concurrent state-federal enforcement authority it is necessary to begin with an understanding of the purpose of federal intervention in the particular substantive area under examination. Regulating the accuracy of disclosures by nationally traded firms creates positive interstate externalities and is widely perceived to be a proper topic of federal interest for this reason.[117] If investors who participate in the national capital markets fear that firms are releasing inaccurate or incomplete information, they can be expected to discount what they are willing to pay for all securities.[118] This works to increase the cost of capital, with negative consequences for the entire economy.[119] Securities fraud by nationally traded firms also upsets

Albergotti et al., *Sharp Elbows Among Street Lawmen*, WALL ST. J., Aug. 30, 2012, at C1.

117. *But see generally* ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION (2002) (advocating for a competitive regime); *cf.* John C. Coates IV, *Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis*, 41 VA. J. INT'L L. 531 (2001) (arguing that the decision to regulate or privatize must consider political implications).

118. Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 673–74 (1984).

119. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on*

the efficient allocation of resources in the country, as it impedes the flow of funds to their highest valued use.[120] Deterring inaccurate and incomplete disclosures by nationally traded firms thus creates benefits that are shared nationwide, and individual states might therefore rationally underinvest in the effort. As noted above, it was Congress's concern that states were under-enforcing that animated it to get involved in securities regulation in the first place.

But state level under-enforcement is not the only relevant concern. Bringing securities fraud cases against nationally traded firms can also produce in-state benefits while creating negative interstate externalities, in the form of over-deterrence costs.[121] An optimal deterrence regime would not deter fraud at any cost, but rather would minimize the sum of under- *and* over-deterrence costs, as well as the other more direct costs of the enforcement regime.[122] Over-deterrence would not be a serious concern if securities fraud liability were directed only at individuals, and the scienter requirement were applied with 100% accuracy.[123] Under these assumptions, people could avoid liability simply by choosing not to defraud—an unambiguously good outcome, since fraud has no social value.[124] But firms (and, ultimately, their shareholders) are held vicariously liable for securities fraud in the United States, and shareholders may be unable to prevent renegade managers from committing fraud. Moreover, securities fraud prohibitions, at least when written in broad terms (as they typically are), carry a nontrivial risk of legal error. In particular, omissions, forward-looking statements, and opinions may be judged to have been made with fraudulent intent even when they were not.[125] Moreover, so-called "aiders and abetters," like auditors or investment banks,

Deterrence and Its Implementation, 106 COLUM. L. REV. 1534, 1565 (2006) ("When the cost of capital rises, the economy as a whole suffers, as Gross National Product declines or stagnates, and unemployment may increase. As a result, not only investors, but also citizens throughout society experience a loss.").

120. Easterbrook & Fischel, *supra* note 118, at 673.

121. Rose, *supra* note 24, at 2184.

122. *Id.* at 2178–79.

123. *See, e.g.*, Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence,* 1992 U. ILL. L. REV. 691, 692 (1992) ("Fraud on the Market is optimally deterred when agents are induced to refrain from fraud altogether, consequently, overdeterrence is not an issue.").

124. *See id.*

125. *Id.* at 2185–86.

can be charged with having known about, and assisted, frauds that they were in fact unaware of.[126]

The risk of these sorts of mistaken fraud prosecutions can produce over-deterrence costs that look very much like the under-deterrence costs the system is meant to prevent. If regulators aggressively pursue forecasts and other opinions, it may prompt even honest individuals to disclose less of this type of information, impeding share price accuracy.[127] Conversely, the aggressive pursuit of omissions might cause individuals to spend too much firm money in the production of information, or to flood the market with trivial information—which can likewise impede share price accuracy.[128] Less accurate share prices mean, in turn, less allocative efficiency in the economy and a higher cost of capital. The risk of erroneous fraud liability might also lead firms to spend more money scrubbing documents for accuracy than is socially optimal. In addition, financial intermediaries might charge firms more for their services as compensation for the risk of erroneous aiding and abetting liability. Finally, when vicarious liability is a feature of the system, excessive sanctions might cause firms to overinvest in measures to prevent fraud and misrepresentation, even absent a risk of legal error.[129]

Enforcement discretion can therefore be a very useful device in the securities fraud context. I have argued elsewhere that it is in fact a superior way of mitigating over-deterrence costs than the alternative of narrowing the breadth of the fraud prohibition, or rigidly altering procedural rules or sanctions.[130] Unlike the latter approaches, which necessarily weaken the

126. *Id.* at 2187.

127. *See* Marilyn F. Johnson et al., *The Impact of Securities Litigation Reform on the Disclosure of Forward-Looking Information by High Technology Firms*, 39 J. ACCT. RES. 297, 298 (2001) (finding an increase in company forecasts after legislation restricted the ability of private parties to bring securities fraud suits based on forward-looking information).

128. *See generally* Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417 (2003).

129. Vicarious liability is not meant to deter unconditionally, the way a fraud prohibition directed at individuals is meant to; rather, it is meant to cause the owners of the firm to internalize the potential social costs of their employees' frauds so as to invest socially optimal amounts in prevention. *See generally* Amanda M. Rose & Richard Squire, *Intraportfolio Litigation*, 105 NW. L. REV. 1679, 1683–85 (2011) (questioning this rationale for vicarious liability in the securities fraud context, given that diversified shareholders have natural incentives to prevent fraud).

130. Rose, *supra* note 24, at 2193–97.

ability of the regime to deter fraud, enforcement discretion—if wisely employed—can reduce over-deterrence costs without the same stark tradeoff in the form of increased under-deterrence costs. For example, a well-incentivized federal enforcer could reduce the fear of erroneous prosecution through careful enforcement choices. It could also reassure firms that vicarious liability will not be imposed even if a renegade employee commits fraud, so long as reasonable internal controls were in place. When concurrent state enforcers are introduced, however, the federal government's control over these policy levers is surrendered. And it is surrendered to states with skewed incentives, due to the potential for fraud prosecutions against nationally traded firms to create interstate externalities. Undoubtedly state enforcement is less problematic in this regard than profit-driven private enforcement,[131] but it is problematic nevertheless.

Thus, both the rationale for federal intervention (to deal with interstate externalities) and the nature of the substantive prohibition (broad and prone to legal error) suggest that concurrent state enforcement in the securities fraud context may lead to policy distortion and, consequently, raise democratic concerns. The magnitude of these costs may be exacerbated by the fact that states are permitted to apply their own state securities fraud laws, rather than to simply enforce federal securities fraud prohibitions.[132] Some have criticized New York's Martin Act, for example, as distorting national policy because it differs from federal securities fraud prohibitions in important respects. For instance, the "fraud" proscribed by the Martin Act does not require a showing of scienter.[133] The Martin Act also

131. In the United States, there is a third type of securities fraud enforcer that should not be overlooked: the entrepreneurial "private attorney general" who brings Rule 10b-5 class actions against nationally traded firms. As I have argued elsewhere, this type of enforcer can likewise undermine the federal government's effective use of prosecutorial discretion as a tool for mitigating over-deterrence costs. *See generally* Rose, *supra* note 99. Although private enforcement's capacity to upset federal policy goals has been cabined somewhat by the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995), it remains problematic. *See generally* Amanda M. Rose, *Fraud on the Market: An Action Without A Cause*, 160 PENNUMBRA 87 (2011).

132. *See, e.g.*, Easterbrook & Fischel, *supra* note 118, at 706 (noting that "[s]tate courts, acting under state law, have used a much broader definition of materiality, giving credence to the interstate exploitation hypothesis"). States can enforce federal fraud prohibitions only in a proprietary capacity, to recoup investment losses suffered by the state.

133. *Id.*

confers on the NYAG powerful tools of pre-suit discovery which some contend may be used to strong-arm defendants into settling.[134]

In addition, because federal law simply preserves states' authority to enforce their own laws, there are none of the safeguards discussed in Part II.B.4 that are often part of concurrent regimes involving the enforcement of federal law. State securities regulators need not inform the SEC of their investigations or enforcement actions against nationally traded firms. Nothing limits state regulatory remedies, or prevents states from bringing actions in cases where the SEC has brought parallel proceedings. Moreover, the SEC has no right to intervene in state proceedings. Although a presidential directive prevents federal agencies from retaining private counsel on a contingency-fee basis,[135] the use of private counsel by state agencies is unregulated by federal law.

Concurrent state enforcement may also be particularly costly in the securities fraud context because of the number of states that enjoy concurrent jurisdiction with the federal government. State jurisdiction over securities fraud is not limited to states where the offending firm is headquartered or incorporated. Instead, it typically extends to all states where an offer or sale of the firm's securities has been made.[136] Thus, each of the fifty states could likely assert jurisdiction over a nationally traded firm based on the same alleged misstatement or omission, because at least one resident is likely to have purchased the firm's shares while the misstatement or omission was allegedly distorting the price. A public firm cannot effectively limit the investors who purchase its shares in the secondary market based on state residency, so it has no choice but to expose itself to this level of jurisdictional overlap.[137]

134. For example, the Martin Act authorizes the NYAG to issue subpoenas compelling testimony without granting the subpoenaed person a right to counsel or a right against self-incrimination—a witness's failure to comply renders him or her guilty of a misdemeanor, and a defendant's failure to comply constitutes prima facie proof of fraud and warrants a permanent injunction barring him or her from further participation in the securities industry. *See* N.Y. GEN. BUS. LAW §§ 352, 354 (McKinney 2012); Jonathan R. Macey, *Positive Political Theory and Federal Usurpation of the Regulation of Corporate Governance: The Coming Preemption of the Martin Act*, 80 NOTRE DAME L. REV. 951, 960–61 (2005); McTamaney, *supra* note 116, at 1.

135. Exec. Order No. 13433, 72 Fed. Reg. 28, 441–42 (May 18, 2007).

136. ROMANO, *supra* note 117, at 115.

137. *See id.* (discussing choice-of-law approach to securities transactions); Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities*

As discussed in Part II.B.3, having numerous states with jurisdiction increases the costs of concurrent enforcement in a variety of ways. For example, it raises the possibility of duplicative enforcement actions and policy distortion, and heightens accountability concerns. But it also increases the potential benefits of concurrent enforcement, most importantly its ability to serve as a meaningful check on federal enforcement laxity—the more states with jurisdiction, the less likely industry will succeed in capturing them all. The importance of this added benefit depends, of course, on whether federal enforcement laxity is a serious concern in the securities fraud context, or more precisely on whether it *would be* in the absence of concurrent state enforcement.

This is not an easy question to answer. Scandals, such as those involving Bernie Madoff and Allen Stanford, have certainly sullied the SEC's reputation in recent years. But historically the agency has enjoyed a positive reputation.[138] It is an independent agency, with the traditional safeguards from executive dominance.[139] In addition, to promote bipartisan decisionmaking no more than three of the SEC's five commissioners can have the same political affiliation.[140] The SEC is also well-funded and well-staffed, at least relative to many other federal agencies.[141] Scholarly research has shown that the SEC brings more enforcement actions and imposes greater monetary sanctions than its European counterparts by orders of magnitude, even when the numbers are adjusted to reflect relative market size.[142]

Fraud Causes of Action, 50 STAN. L. REV. 273, 325–26 (1998) (same).

138. For a comprehensive history of the SEC, see generally JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET (3d ed. 2003). *See also* Coates, *supra* note 121, at 543–44 ("[T]he SEC remains a highly respected government agency, even among political constituencies otherwise inclined to doubt the value or abilities of government regulators.").

139. *See* Bressman & Thompson, *supra* note 96, at 610 (discussing the hallmarks of independent agencies); *but see id.* at 637–47 (discussing mechanisms that nevertheless cause the SEC to be responsive to presidential preferences).

140. 15 U.S.C. § 78d(a) (2006).

141. In the 2011 fiscal year, the SEC enjoyed a budget of over $1.6 billion, boasted 3844 full-time employees, brought 735 enforcement actions, and obtained orders for $2.8 billion in penalties and disgorgement. FY 2011 Performance and Accountability Report, SEC (Nov. 15, 2011), *available at* http://www.sec.gov/about/secpar/secpar2011.pdf.

142. Coffee, *supra* note 99, at 262, 268–74 (discussing and updating figures reported in Howell E. Jackson, *Variation in the Intensity of Financial Regula-*

Nevertheless, many scholars argue that the SEC is underfunded and understaffed given the scope of its responsibilities.[143] Many also contend that the SEC is subject to capture and that its personnel are seduced by the lure of a "revolving door," leading to under-deterrence.[144] As I have discussed in detail elsewhere, these sorts of arguments are premised on important unstated assumptions that should be identified, and their veracity examined.[145] Rather than rehash that analysis here, I will assume that SEC enforcement laxity is in fact a serious concern. I will also assume that there are no other fixes, short of adopting a concurrent enforcement regime, which might remedy the SEC's problems at less cost.[146]

The question still remains whether state enforcement does more good, by checking or correcting the SEC's tendency to under-enforce and producing other benefits, than harm, by creating over-deterrence and other costs. The features of concurrent state securities fraud enforcement discussed above suggest it has the potential to create significant costs. But whether it does in fact depends on how states actually choose to utilize their enforcement authority. The same is true of its potential to produce the benefits traditionally associated with concurrent en-

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tion: Preliminary Evidence and Potential Implications, 24 YALE J. ON REG. 253 (2007)).

143. *See, e.g.*, Jones, *supra* note 35 at 126–27 ("Because the SEC lacks adequate resources to effectively police the national securities market, supplemental enforcement is essential to achieve an appropriate level of deterrence."); Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 652 (1996) (accepting this as "the conventional view").

144. *See, e.g.*, Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 GA. L. REV. 63, 99 (2008) (discussing the need to guard against "selective enforcement and inaction by the SEC"); Jones, *supra* note 35, at 122 (arguing in favor of concurrent state securities enforcement because "the existence of multiple layers of government makes regulatory capture a more arduous task for interest groups"); Macey, *supra* note 134, at 958 (suggesting the SEC's passivity in the wake of corporate scandals "was likely caused by the agency's capture by the very special interests it was ostensibly regulating"); *cf.* Fisch, *supra* note 94, at 623 (noting the increasing "power of a variety of other interest groups," including shareholders, trial lawyers, and employees).

145. Rose, *supra* note 24, at 2212–19; *see generally* Ed DeHaan et al., Does the Revolving Door Affect the SEC's Enforcement Outcomes? (July 2012) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2125560 (finding evidence inconsistent with the claim that revolving doors undermine the SEC's enforcement efforts).

146. *But see* Rose, *supra* note 24, at 2224–29 (discussing a variety of SEC-focused reforms that might improve the securities fraud deterrence regime at lower cost than concurrent enforcement).

forcement. To get at the answer to this question, then, empirical research is needed. The next Part reports on the most comprehensive empirical examination of state securities enforcement behavior against nationally traded firms undertaken to date.

IV. STATE SECURITIES ENFORCEMENT: AN EMPIRICAL ASSESSMENT

While the role of federal public enforcement and private class action enforcement of the securities laws has been well studied,[147] almost no empirical research has been done on state regulatory enforcement. The debate over NSMIA's fraud carve-out has therefore been based on anecdotal accounts of high-profile enforcement efforts by New York and a handful of other states. To begin to fill this gap in the literature, I and a co-author constructed a unique dataset of litigation-related disclosures drawn from the fiscal year 2004, 2005, and 2006 annual reports filed with the SEC by every domestic firm that listed common stock on the NYSE at any point between February 29, 2000 and December 31, 2010.[148] This involved a review of 5441 Form 10-Ks filed by 1977 distinct companies. Among other things, we tracked whether the companies disclosed some form of securities litigation and, if so, what type. We also recorded detailed information about the securities-related state regulatory investigations and actions that were disclosed.

Of the 538 companies in the dataset disclosing some form of securities litigation in at least one of their examined Form 10-Ks, 8% disclosed a state regulatory investigation or action.[149] A total of 42 companies reported 102 distinct securities-related

147. For helpful summaries of the extant literature, see James D. Cox & Randall S. Thomas, *Mapping the American Shareholder Litigation Experience*, 6 EUR. CO. & FIN. L. REV. 164 (2009). For an older survey focused on private enforcement, see Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465, 1468–1504 (2004).

148. Amanda M. Rose & Larry J. LeBlanc, *Policing Public Companies: An Empirical Examination of the Enforcement Landscape and the Role Played by State Securities Regulators*, 65 FLA. L. REV 448, 452–57 (2013) (describing the data collection process). We chose to focus on NYSE listed firms because the NYSE is by far the largest U.S. stock exchange by market capitalization; focusing on firms that listed common stock on that exchange over a ten year period thus gave us a window into the litigation experiences of a broad set of U.S. public companies. We chose to focus on these firms' disclosed litigation experiences in the years 2004–2006 in order to maximize the likelihood that the litigation would be completed.

149. *Id*. at 460 (Table 1).

state regulatory matters, 90 of which we could attribute to particular states.[150] By contrast, 45% of these 538 companies disclosed being the target of a securities-related federal regulatory investigation or action in at least one of their examined Form 10-Ks,[151] and 74% reported being targeted in a securities class action.[152] Thus, at least relative to these other forms of securities enforcement, the level of disclosed activity by state enforcers was low.

This is consistent with theory. As explained above, policing public companies for securities fraud can serve a deterrent function that helps to maintain the health of our national capital markets, a benefit that necessarily transcends the boundaries of any particular state. It can also be very costly to do. If states are rational actors, one might therefore expect them to do little to combat securities fraud by public companies, and to instead free-ride on the efforts of the federal government or other states (focusing their limited resources on more localized issues, with fewer spillover benefits). The data suggest that most states act in this expected way. Indeed, a clear majority of states (thirty-two) were not identified as having brought any securities-related investigations or actions against the companies in the dataset.[153] Of course, this does not mean that these states' securities regulators were not hard at work; the more appropriate inference is that they were directing their scarce resources to securities-related misconduct of a more local ilk.[154]

But the data also reveal four states that were fairly active. New York, West Virginia, Connecticut, and Massachusetts were each disclosed as having brought between eight and thirty-one securities-related investigations or actions against the companies in the dataset.[155] These states were alone responsible for 70% of the ninety disclosed matters attributable to particular states.[156] Another fourteen states were disclosed to have

150. *Id*. at 466 (Table 4).

151. We defined federal regulatory matters to include those "brought by the SEC, securities-related criminal matters brought by the Department of Justice, and enforcement matters initiated by SEC supervised self-regulatory organizations." *Id*. at 455 n.18.

152. *Id*. at 460 (Table 1).

153. *Id*. at 467.

154. "For example, states have played an important role in protecting elders from securities scams as well as in policing for fraud in the sale of unregistered securities." *Id.* at 466 n.51.

155. *See id.* at 22 (Table 6).

156. *Id.*

brought between one and four actions or investigations.[157] The interesting question is not why there were so few securities-related state regulatory matters disclosed, but rather why some states saw fit to bring any at all. What motivates some states to act while others sit on the sidelines? As discussed in Part II.D, predicting how or why states will use their concurrent enforcement authority is a complex task, and yet understanding state enforcement behavior is necessary to intelligently evaluate the social value of NSMIA's fraud carve-out. I therefore used this unique dataset to evaluate (both qualitatively and, where possible, quantitatively) the plausibility of the four hypotheses about state enforcement behavior introduced in Part II.D—the Vacuum Filling, Rent Seeking, Cooperation, and Political Entrepreneur Hypotheses.

Part IV.A, below, describes some basic characteristics of the securities-related state regulatory matters disclosed in the dataset. Part IV.B then discusses the results of my hypothesis testing. To preview those results, each hypothesis finds some support in the data. Consistent with the Political Entrepreneur Hypothesis, states with elected securities regulators were much more active than states with appointed securities regulators, even when controlling for other differences that might be expected to influence a state's enforcement activity. Consistent with the Cooperation Hypothesis, in some cases it appears that state regulators took the enforcement lead against public companies when they enjoyed an enforcement advantage relative to federal regulators. In the vast majority of cases, however, I observed more conflict than coordination, with both state and federal regulators pursuing the same companies for the same misconduct. Many of these cases—in particular those brought by the NYAG—appear consistent with the Vacuum Filling Hypothesis, as they involved a state with a special concern for the health of the capital markets exposing widespread securities-related misconduct, jolting a restful SEC into action. A nontrivial number, however, were "piggyback" actions brought by West Virginia—a state with no special connection to the capital markets, the defendants, or the alleged misconduct. Consistent with the Rent Seeking Hypothesis, West Virginia sought significant monetary penalties against the targeted firms (and, indirectly, their public shareholders) for misconduct that had already been exposed and seriously sanctioned by other regulators. These results indicate that NSMIA's fraud carve-

157. *Id.*

out has produced both social costs and social benefits. In the final section of this Part, I will discuss nuanced reforms that might preserve the carve-out's positive potential while minimizing its ability to do harm to our capital markets.

A. SNAPSHOT OF STATE ACTIONS & INVESTIGATIONS

The securities-related state regulatory matters disclosed in the dataset share a few notable common characteristics. First, states tended to target out-of-state defendants. In 68% of the ninety disclosed state matters that could be attributed to particular states, states targeted firms that were neither headquartered nor incorporated within the enforcing state.[158]

Second, the disclosed state matters were almost always accompanied by a related enforcement action by another securities law enforcer. Companies that disclosed being targeted by a state securities regulator also disclosed litigation at the hands of another securities law enforcer with respect to the same or related misconduct 93% of the time, reporting a related federal regulatory action or investigation 91% of the time, and related private litigation 67% of the time.[159]

Finally, state regulators overwhelmingly targeted firms in the financial sector and focused on industry-wide scandals rather than one-off frauds. A full "93% of the targeted firms hail from the financial sector."[160] And the vast majority of the 102 disclosed state matters (85%) related to four highly publicized industry-wide scandals, each scandal at a slightly different stage of its life cycle in the time period examined: (1) the mutual fund industry scandal over market timing and late trading (46%); (2) the insurance industry scandal involving the use of non-traditional insurance products to manipulate financial results (17%); (3) the investment banking scandal over biased analyst research and IPO allocation practices (9%); and (4) the mutual fund industry scandal over certain marketing practices, such as directed brokerage (8%).[161] An additional six actions

158. *Id.* at 475 n.72.

159. *Id.* at 473 (Table 9).

160. *Id.* at 473–74 & n.71.

161. *Id.* at 475 (Figure 1). For background on these scandals, see id. at 463 nn.43–44, 473 n.68 & 474 n.70. It is interesting that, with the exception of the finite insurance matters, these are not typical "fraud-on-the-market" cases involving operating companies disseminating false information to the marketplace in an effort to inflate their stock prices. The finite insurance scandal involved operating companies allegedly misrepresenting their financial results, with the help of the insurance industry. But the mutual fund and biased re-

(6%) related to one of the two mutual fund industry scandals just mentioned, but ambiguity in the disclosures made it impossible to determine which. The remaining 15% of the disclosed securities-related state regulatory matters involved other types of misconduct. This subset also involved a large degree of overlap with federal regulatory efforts (73%), but less so than the group of securities-related state regulatory matters overall (91%).

B. Hypothesis Testing

In this section, the plausibility of each of the four hypotheses about state enforcement behavior introduced in Part II.D is evaluated in light of the data. As with any empirical endeavor, caution is necessary when interpreting results. Perhaps the biggest limitation of this dataset is that it covers only disclosures made in the studied companies' fiscal year 2004, 2005 and 2006 Form 10-Ks.[162] Enforcement patterns may change with the times, and it would therefore be preferable to have data spanning a much longer period. That said, this dataset offers more insight into state securities enforcement behavior than has previously been available.

1. Vacuum Filling

If federal authorities did in fact under-deter securities fraud by public companies, the costs would be felt more acutely in some states than others. This leads to the hypothesis that the more sensitive a state's citizenry is to the health of the national capital markets, the more likely that state's government will take meaningful steps to fill voids created by federal under-enforcement. While such activity may be costly, and may create positive externalities, the state may capture enough of

search scandals involved financial service providers allegedly defrauding their clients, and thus may seem as much about "consumer protection" as "investor protection." But it would be incorrect to view these scandals as simply involving localized consumer abuses. Both mutual fund scandals challenged the accuracy or completeness of disclosures in nationally disseminated mutual fund prospectuses; the biased research scandal challenged the accuracy of nationally disseminated research reports and recommendations. It should be noted that when financial service providers engage in deceptive practices toward clients on such a scale, it—like fraud-on-the-market by operating companies—can work to discourage investors from participating in the capital markets and thus increase the cost of capital. Overly-aggressive enforcement against such firms can likewise raise the cost of capital, by making financial services more expensive and thus discouraging participation in the capital markets.

162. For a discussion of the dataset's other limitations, see *id.* at 455–57.

the deterrence benefits to make it worthwhile. This hypothesis is consistent with academic arguments that NSMIA's fraud carve-out may be socially valuable because the prospect of state enforcement serves as an important check on SEC capture and complacency.

Quantitative testing of this hypothesis did not produce support. A regression was run to test the relationship between various independent variables and a state's level of disclosed enforcement activity.[163] These included independent variables relevant to this hypothesis. For example, population was one of the independent variables, and states with larger populations likely internalize a bigger portion of the harm caused by public companies' securities-related misconduct, and thus might be expected to invest more in deterring it. The number of public companies headquartered in the state, and the percentage of state GDP attributable to the financial sector, were also used as independent variables. The number of public companies headquartered in a state might bear a positive relationship to the level of a state's enforcement activity, if being home to public companies makes a state more sensitive to the cost of capital, and if greater enforcement helps reduce the cost of capital (by, for example, increasing investors' confidence in company disclosures). Similarly, the dependence of a state's economy on the financial sector might bear a positive relationship to the level of a state's enforcement activity, if greater enforcement benefits the financial sector (by, for example, increasing confidence in the markets and hence the number of fee-generating financial transactions).[164] The results of the regression showed no statistically significant relationship between any of these variables and the number of investigations and actions a state brought.

But quantitative testing of this hypothesis is problematic. As discussed below in connection with the Rent Seeking Hypothesis, the same independent variables might bear an *inverse*

163. "We selected a negative binomial model because our variable of interest [wa]s over-dispersed count data, specifically the number of state actions and investigations brought by each state." *See id.* at 471 & n.55. For full regression results, see *id.* at 493 (Table A.12).

164. It is also possible that the number of public companies headquartered in the state, and the percentage of state GDP attributable to the financial sector, might bear a negative relationship to enforcement activity if they increase the likelihood that a state is "captured" by managerial interests who prefer lax enforcement, or if greater enforcement is not in fact beneficial in the ways assumed above.

relationship with the number of enforcement actions brought, if states bring actions for opportunistic rather than vacuum-filling purposes—just as states that are particularly sensitive to the health of the capital markets are more likely to bring "good" enforcement actions, states that are particularly *in*sensitive to the health of the capital markets are more likely to bring "bad" ones. If both the Vacuum Filing and Rent Seeking Hypotheses are true (and there is no reason why they cannot be), the behavior of these two groups of states might cancel out any explanatory significance of variables tied to a state's sensitivity to the health of the capital markets.

A qualitative analysis of the data may therefore be more illuminating. I undertook such an analysis, and found some tentative support for the Vacuum Filling Hypothesis—though it clearly cannot explain all of the disclosed enforcement actions. The data revealed New York to have the most active state securities enforcer vis-à-vis the companies in the dataset by a wide margin. As explained below, New York's unique sensitivity to the national capital markets, and the nature of the actions and investigations it brought against the companies in the dataset, render its behavior arguably consistent with the Vacuum Filling Hypothesis. Besides New York, only three other states were identified as having brought more than four actions or investigations against the companies in the dataset: West Virginia (14), Connecticut (10), and Massachusetts (8).[165] Like New York, both Connecticut and Massachusetts might be viewed as having an outsized interest in the health of the national capital markets relative to most states. However, their enforcement activity does not lend significant support to the Vacuum Filling Hypothesis, given that the actions and investigations they brought did not fill significant enforcement gaps. West Virginia's activity is clearly inconsistent with this hypothesis.

a. New York

Perhaps more so than any other state, New York's economy is dependent on healthy, active and liquid U.S. capital markets. New York is, after all, the "financial capital of the world."[166] According to a 2007 McKinsey report commissioned by New York City Mayor Michael Bloomberg and U.S. Senator Chuck

165. Rose & LeBlanc, *supra* note 148, at 468 (Table 6).

166. *See, e.g.*, Kathryn Cooper, *New York Ousts London as World Financial Capital*, SUNDAY TIMES (UK) (Nov. 11, 2012), *available at* http://www.thesundaytimes.co.uk/sto/business/Finance/article1161834.ece.

Schumer, "the financial services sector is even more critical to the New York economy than to the country as a whole"—representing "approximately 15% of real gross product for both New York City and New York State" (as compared to 8% of national GDP) and accounting for "approximately 36% of [New York] City's business income tax revenues" and "1 in every 9 private sector jobs" (as compared to one in nineteen nationally).[167] New York also claims the second highest number of principal executive offices of the public companies in the dataset.[168] Thus, if any state should be concerned about SEC enforcement failures that dampen investor confidence in our capital markets, one might expect it to be New York.

Moreover, most of the enforcement actions and investigations that New York brought against the companies in the dataset involved widespread financial sector abuses that the SEC had not (at least prior to New York's efforts) taken aggressive action to remedy—most notably in this time period the practice of mutual fund advisers to allow favored investors to engage in market timing and late trading in managed funds.[169] After the mutual fund scandal first broke, the Wall Street Journal reported that the SEC was "scrambling to keep up" with the New York Attorney General (NYAG), just as it had after the NYAG broke the scandal over biased analyst research in 2002.[170] A report prepared by the SEC's Office of the Inspector General (OIG) corroborates this, explaining how the SEC chose to follow up on complaints about permitted market timing in Putnam mutual funds only after Spitzer released a public complaint against Canary Capital accusing multiple funds of allowing market timing; an SEC official testified that after the Canary Complaint became public, "the SEC's interest in market-timing issues was heightened."[171]

167. MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP 35–36 (2007), *available at* http://www.nyc.gov/html/om/pdf/ny_report_final.pdf.

168. *See* Rose & LeBlanc, *supra* note 148, at 482 (Table A.3).

169. Nineteen of New York's disclosed actions and investigations involved market timing allegations; four involved finite insurance; two involved biased analyst research; one involved mutual fund marketing issues; one involved either market timing or mutual fund marketing issues (the author could not tell which); and four involved other allegations.

170. Tom Lauricella, *For Staid Mutual-Fund Industry, Growing Probe Signals Shake-Up*, WALL ST. J., Oct. 20, 2003, at A1.

171. *See* SEC Office of Inspector General, Memorandum of Inquiry PI No. 09-38, at 6 (Nov. 6, 2009), *available at* http://www.sec.gov/news/studies/2009/pi-09-38.pdf. A former Putnam employee named Peter Scannell had complained

To be sure, the SEC's failure to root out market timing and late trading in the mutual fund industry prior to the NYAG's efforts need not be viewed as an indication of its capture by those it regulates. It had taken some efforts to combat arbitrage trading in mutual funds prior to Spitzer's efforts,[172] just as it had been considering reforms to deal with biased analyst research before Spitzer took an interest in that topic.[173] Moreover, New York's enforcement efforts could be criticized as not advancing the goal of optimal deterrence so much as the political ambition of Eliot Spitzer, a theory explored below in connection with the Political Entrepreneur Hypothesis.[174] But New York's activity is at least arguably consistent with the Vacuum Filling Hypothesis—a state with a heightened sensitivity to the capital markets stepping up to fill voids left by federal underenforcement.

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to the SEC about market timing in Putnam funds in April of 2003, but the SEC did not take action against the company until the filing of Eliot Spitzer's complaint against Canary in September 2003 put market timing in the headlines. At approximately the same time that the SEC opened an investigation, Scannell took his complaint to the office of the Secretary of the Commonwealth of Massachusetts, which initiated its own investigation. Scannell later went to the OIG, claiming the SEC had improperly acted to protect Putnam, a claim the OIG rejected. *See generally id*.

172. *See, e.g.*, 17 C.F.R. § 270.22c-1 (2012); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-313, MUTUAL FUND TRADING ABUSES: LESSONS CAN BE LEARNED FROM SEC NOT HAVING DETECTED VIOLATIONS AT AN EARLIER STAGE 4 (April 2005) ("SEC staff made good faith efforts to control the known risks associated with market timing through the regulatory process.").

173. *See, e.g.*, Regulation Analyst Certification, Securities Act Release No. 33-8119, Exchange Act Release No. 34-46301, 67 Fed. Reg. 51,510 (proposed Aug. 8, 2002) (reporting on the SEC's efforts in this regard beginning in 1999).

174. *See infra* Part IV.B.4. The SEC, for one, was openly critical of Spitzer's decision to make mutual fund advisors reduce management fees as part of their market timing settlements with the NYAG. The SEC had chosen not to make fee reductions a condition of the market timing settlements it entered, explaining that it saw "no legitimate basis for the Commission to act as a 'rate-setter' and determine how much mutual fund customers should pay for the services they receive in the future"—a decision "better left to informed consumers, independent and vigorous mutual fund boards, and the free market." Press Release, SEC, Alliance Capital Management Will Pay Record $250 Million and Make Significant Governance and Compliance Reforms to Settle SEC Charges (Dec. 18, 2003), http://www.sec.gov/news/press/2003-176.htm.; *see also* John C. Coffee, Jr., *A Course of Inaction*, LEGAL AFFAIRS, March/April 2004, at 49 (observing that a cause of SEC passivity with respect to market timing "may have been the fear that harsh penalties and rhetorical condemnations would produce an undesirable 'run on the funds,' leading to massive withdrawals from the mutual fund industry").

b. Connecticut

Connecticut has obvious ties to New York; indeed, a majority of the state's population is part of the New York City metropolitan area.[175] Connecticut also counts on the financial services sector for over 10% of its real gross product, something that is true for only six other states, according to the McKinsey report.[176] The financial services sector also provides one in every eight private sector jobs in Hartford, Connecticut's capital city.[177] Connecticut is also among the top ten states claiming the most principal executive offices of public companies in the dataset,[178] and is home to many hedge funds.[179] It is therefore reasonable to assume that Connecticut has more of a stake in the health of our national capital markets than many states.

As the so-called "Insurance Capital of the World," Connecticut also has a special interest in ensuring the integrity of the insurance corner of the financial sector in particular.[180] It is thus notable that 60% of the securities-related enforcement actions and investigations Connecticut was disclosed to have brought against the companies in the dataset involved the industry-wide scandal over the alleged improper accounting of finite insurance products. Connecticut did not "break" this scandal the way that New York broke the market timing scandal, however. Both the SEC and the NYAG began probes into the misuse of finite insurance products before Connecticut entered the fray,[181] and one or both of these regulators took parallel ac-

175. James Orr & Giorgio Topa, Fed. Res. Bank of N.Y., *Challenges Facing the New York Metropolitan Area Economy*, 12 CURRENT ISSUES IN ECONOMICS AND FINANCE, 1 n.1 (Jan. 2006), *available at* http://www.newyorkfed.org/research/current_issues/ci12-1.pdf.

176. The others are New York, Massachusetts, Delaware, North Carolina, Rhode Island, and South Dakota. *See* BLOOMBERG & SCHUMER, *supra* note 167, at 35.

177. *Id.* at 36.

178. *See* Rose & LeBlanc, *supra* note 148, at 482 (Table A.3).

179. *See* Claude Schwab, *The Top 5 U.S. Cities Seeking Hedge Fund Talent*, INST. INVESTOR'S ALPHA (May 31, 2011), http://www.institutionalinvestorsalpha.com/article/2839531/The-Top-5-US-cities-seeking-hedge-fund-talent.html ("After New York, Connecticut has the second largest number of funds managing $1 billion or more and ranks third in the world, after London, according to industry estimates.").

180. *See, e.g.*, Jamie Kageleiry, *The Insurance Capital of the World*, YANKEE (May 1990), *available at* http://new.yankeemagazine.com/article/insurance-capital-world.

181. *See* Dean Starkman & Carrie Johnson, *Loss of Coordination: Spitzer and Federal Officials Pursuing Insurance Probe Separately*, WASH. POST, July 19, 2005, at D1.

tion against four of the six companies in the dataset that Connecticut reportedly investigated regarding these products. It is possible that Connecticut's enforcement activity was designed to supplement what it perceived to be an unduly weak enforcement response by these other regulators, something that would be consistent with the Vacuum Filling Hypothesis. But a review of Connecticut's efforts does not recommend this as a very plausible interpretation, as the state rarely pursued matters past the investigative phase.[182] It is also possible that Con-

182. The two companies Connecticut targeted related to finite insurance which were not apparently targeted in a parallel SEC or NYAG investigation were MetLife, Inc. and Phoenix Companies, Inc. Connecticut's efforts against these firms, as well as the other four it targeted in connection with finite insurance, are briefly described below. In addition to these six actions, Connecticut brought two actions or investigations related to market timing: one related to mutual fund marketing practices, and one concerning other alleged misconduct.

MetLife, Inc. disclosed receiving a subpoena from the Connecticut Attorney General requesting information regarding its participation in any finite reinsurance transactions, as well as receiving similar information requests from "other regulatory and governmental entities." MetLife, Inc., Annual Report 38 (Form 10-K) (Feb. 28, 2006). It does not appear that these investigations amounted to any formal prosecution against the firm.

Phoenix Companies, Inc. also disclosed receiving a subpoena from the Connecticut Attorney General's Office as well as an inquiry from the Connecticut Insurance Department requesting information regarding finite reinsurance. *See* Phoenix Cos. Inc., Annual Report 22 (Form 10-K) (March 2, 2006). It does not appear that any further action was taken against the company.

Berkshire Hathaway, Inc. disclosed that its Connecticut-based subsidiary General Reinsurance (General Re) received a subpoena from the Connecticut Attorney General related to the company's sale of non-traditional insurance products. It does not appear that the Connecticut Attorney General took any further action against the company. General Re paid substantial fines to settle related charges filed by the SEC. *See, e.g.*, Press Release, SEC, SEC Charges General Re Corporation for Role in AIG and Prudential Accounting Frauds (Jan. 20, 2010), http://www.sec.gov/news/press/2010/2010-10.htm. Berkshire also disclosed related investigations by the DOJ, NYAG, and various state insurance departments. *See* Berkshire Hathaway, Inc., Annual Report 50 (Form 10-K) (March 1, 2006).

Chubb Corporation disclosed reaching a joint settlement with the attorney generals of New York, Connecticut and Illinois related to a variety of issues, including finite reinsurance. *See* The Chubb Corp., Annual Report 37 (Form 10-K) (Feb. 28, 2007). The settlement involved the payment of $17 million and certain business practices reforms. *See* Press Release, NYAG, Chubb Agrees to Forgo All Contingent Commissions (Dec. 21, 2006), http://www.ag.ny.gov/press-release/chubb-agrees-forgo-all-contingent-commissions. New York—not Connecticut—apparently led the investigative effort. *See* Press Release, Chubb Group of Insurance Companies, Chubb Settles with New York, Connecticut and Illinois AGs (Dec. 21, 2006), http://www.chubb.com/corporate/chubb6132.html. Chubb also disclosed receiving subpoenas and requests for information from federal regulators, including the SEC and DOJ, relating to certain finite reinsurance products. *See* The Chubb Corp., Annual Report 15 (Form 10-K) (March 3, 2006).

necticut conducted investigations to determine whether the federal government's response was appropriately strong, and then dropped matters after determining that it was.

Interestingly, Democrat Richard Blumenthal, Connecticut's elected Attorney General at the time, was involved in all of the actions and investigations Connecticut was disclosed to have brought related to finite insurance. By contrast, the State's Republican-appointed Insurance Commissioner, Susan Cogswell, played a role in only one. The *Hartford Courant* reported in late 2004 that Cogswell had been criticized for not playing a more proactive role in investigating scandals besetting the insurance industry, and contrasted her understated approach to publicity with "the politically ambitious . . . Blumenthal, who court[s] the news media."[183] The Attorney General was also responsible for three of the four other securities-related investigations or actions Connecticut brought against companies in the dataset, with Connecticut's Republican-appointed Banking Commissioner—the official with primary responsibility for enforcing the state's securities laws[184]—bringing only one. These facts do not speak to whether Con-

Marsh & McLennan Companies, Inc. disclosed receiving, as early 2003, subpoenas and requests for additional information relating to the SEC's investigation of non-traditional insurance products. It also disclosed receiving "similar inquiries from regulators and other authorities in several states," including Florida, Georgia and Connecticut. *See* Marsh & McLennan Cos. Inc., Annual Report 80 (Form 10-K) (March 1, 2006). The Connecticut Attorney General ultimately entered a settlement with a Marsh subsidiary, although the focus of that case was anticompetitive conduct rather than securities-related issues. *See* Press Release, Guy Carpenter, Guy Carpenter Settles Connecticut Attorney General's Lawsuit (Jan. 31, 2011), *available at* http://www.guycarp.com/portal/extranet/press/PDF/2011/110131_GuyCarpenter_ConnecticutAG.pdf?vid=1

Prudential Financial, Inc. disclosed that in April 2005 it voluntary undertook a review of its accounting for reinsurance arrangements; subsequently, the company "received a formal request from the Connecticut Attorney General for information regarding its participation in reinsurance transactions generally and a formal request from the SEC for information regarding certain reinsurance contracts entered into with a single counterparty." *See* Prudential Fin. Inc., Annual Report 160 (Form 10-K) (Feb. 28, 2006). The SEC brought related charges in 2008; Prudential settled them without paying a fine. *See* Prudential Fin. Inc., Annual Report 230 (Form 10-K) (Feb. 26, 2009). It does not appear that the Connecticut Attorney General pursued a case against the firm.

183. Diane Levick, *Insurance Commissioner Answers Her Critics: Some Want Cogswell to Play a More Proactive Role in Industry Scandals*, HARTFORD COURANT, Nov. 28, 2004, http://articles.courant.com/2004-11-28/news/0411280651_1_insurance-commissioners-insurance-industry-connecticut-insurance.

184. *See* CONN. GEN. STAT. § 36b-4(d) (2011).

necticut's actions and investigations played an important vacuum-filling role. They do, however, suggest that the Political Entrepreneur Hypothesis may provide at least a complementary explanation of Connecticut's behavior.

c. Massachusetts

Massachusetts, which shares borders with both New York and Connecticut, is one of the seven states that the McKinsey report indicates owe more than 10% of their real gross product to the financial services sector.[185] That sector also accounts for one in every fourteen private sector jobs in Boston, its capital and largest city.[186] Out of the fifty states, it claims the eleventh most principal executive offices of the public companies in the dataset.[187] Thus, it too may have an outsized interest in the health of our national capital markets, relative to many other states.

Massachusetts may also have a particular interest in the mutual fund industry. The state is considered the historic birthplace of the modern mutual fund,[188] and mutual funds are commonly organized as Massachusetts business trusts today.[189] Just as Connecticut focused its efforts on securities offenses implicating the insurance industry,[190] Massachusetts focused its efforts on abuses in the mutual fund industry—each company it targeted reported being investigated by the state in connection with market timing. This might be seen as a state with a special interest taking steps to fill enforcement gaps, consistent with the Vacuum Filling Hypothesis. But given the considerable enforcement efforts taken to remedy these abuses by both New York and (in its wake) the SEC,[191] there is reason to be skeptical of this view. Indeed, every company that disclosed being targeted by Massachusetts also disclosed being targeted by one or both of these other enforcers, and each reached sub-

185. BLOOMBERG & SCHUMER, *supra* note 167, at 35.

186. *Id.* at 36.

187. *See* Rose & LeBlanc, *supra* note 148, at 482.

188. *See* James E. McWhinney, *A Brief History of the Mutual Fund*, INVESTOPEDIA (Sept. 7, 2009), http://www.investopedia.com/articles/mutualfund/05/MFhistory.asp#axzz21eQR0EQu.

189. Robert C. Illig, *What Hedge Funds Can Teach Corporate America: A Roadmap for Achieving Institutional Investor Oversight*, 57 AM. U. L. REV. 225, 280 n.245 (2007).

190. *See supra* Part IV.B.1.b.

191. *See supra* Part IV.B.1.a.

stantial settlements with the SEC.[192] In one case, however, Massachusetts's Secretary of State William Galvin did indicate his dissatisfaction with the company's SEC settlement, which permitted the defendant to neither admit nor deny the allegations.[193] Unlike the SEC, Galvin insisted that the company admit to factual allegations, going so far as to force it to file an

192. The data revealed five companies targeted by Massachusetts for alleged market timing abuses (some of these companies also disclosed being investigated by Massachusetts regarding other topics, such as mutual fund marketing practices). The outcome of these actions is briefly described below:

Prudential Financial reached a $600 million joint settlement with federal regulators and Massachusetts, $5 million of which was paid to Massachusetts. *See* Press Release, U.S. Dep't of Justice, Prudential Financial Subsidiary Agrees to Pay $600,000,000 in Largest Resolution of Market Timing Case (Aug. 28, 2006), http://www.justice.gov/usao/ma/news/Prudential/Prudential.pdf.

Franklin Resources, Inc. reached a $50 million settlement with the SEC. *See* Franklin Advisers, Inc., *Investment Advisers Act Release No. 2,271, Investment Company Act Release No. 26,523* (Aug. 2, 2004), http://www.sec.gov/litigation/admin/ia-2271.htm (Order Instituting Administrative and Cease-and-Desist Proceedings). It reached a separate $5 million settlement with Massachusetts. *Franklin Settles with Massachusetts, Again*, L.A. TIMES, Nov. 23, 2004, at C5.

Marsh & McLennan Companies, Inc. reached a $55 million settlement with the SEC and a simultaneous $55 million settlement with Massachusetts, on behalf of its Boston-headquartered subsidiary Putnam Investments. *See* Jonathan Fuerbringer, *Putnam Settles S.E.C. Complaint on Market Timing for $110 Million*, N.Y. TIMES, Apr. 9, 2004, at C1.

A.G. Edwards reported that in February 2005 "Massachusetts filed . . . an administrative complaint against Edwards concerning certain mutual fund transactions in Edwards' Boston-Back Bay office." A.G. Edwards Inc., Annual Report 9 (Form 10-K) (May 11, 2006). It is unclear how this litigation was resolved. The SEC also brought market timing claims against A.G. Edwards, which the company ultimately settled in 2007. *See* Press Release, SEC, SEC Charges A.G. Edwards with Failing to Supervise Brokers who Engaged in Illegal Market Timing: A.G. Edwards Agrees to Pay $3.86 Million to Settle Charges; SEC Also Charges Two Brokers and Two Branch Managers with Misconduct (May 2, 2007), http://www.sec.gov/news/press/2007/2007-84.htm.

Morgan Stanley reported receiving "subpoenas and requests for information from various regulatory and governmental agencies, including the Attorney General of the State of New York, the SEC, NASD, the Massachusetts Securities Division, the U.S. Attorney's Office of Massachusetts and the Office of the State Auditor and the Attorney General of West Virginia in connection with industry-wide investigations of broker-dealers and mutual fund complexes relating to possible late trading and market timing of mutual funds." Morgan Stanley, Annual Report 18 (Form 10-K) (Feb. 11, 2005). It is not clear whether Massachusetts pursued any formal action against the company. The company did ultimately agree to pay $17 million to the SEC in settlement of charges that it allowed hedge fund clients to deceptively market-time certain mutual funds. *See* Morgan Stanley, Exchange Act Release No. 56,980, Investment Company Act Release No. 28,078 (Dec. 18, 2007), http://www.sec.gov/litigation/admin/2007/34-56980.pdf (Order Instituting Administrative and Cease-and-Desist Proceedings).

193. *See Franklin Settles with Massachusetts, Again*, *supra* note 192.

amendment to its SEC settlement documents.[194] Thus, it is possible that Massachusetts was playing a vacuum-filling role of sorts by pushing for more meaningful sanctions than federal regulators were demanding.[195] As with New York and Connecticut, political ambition may also play an explanatory role—Galvin was rumored to be considering a gubernatorial bid during this time frame.[196]

d. West Virginia

Whereas an argument can be made that the enforcement activity of New York (and, less convincingly, Connecticut and Massachusetts) is consistent with the Vacuum Filling Hypothesis, giving credence to the claim that NSMIA's fraud carve-out serves a socially useful function, the same simply cannot be said for West Virginia's activity—which is second in volume only to New York's. First of all, West Virginia's economy has no special dependence on the financial sector. To the contrary, it owes far less of its real gross product to the financial sector than the nation overall.[197] It also claims the principal executive offices of only one of the companies in the dataset. Second, the actions that it brought filled no vacuums—each was clearly a

194. *See id.*; Todd Wallack, *Franklin Settles for $50 Million*, S.F. CHRON., Aug. 3, 2004, at C1 (reporting that the Secretary said, "[w]e tend to be among the last to settle, because we insist on some admission of wrongdoing").

195. The suggestion that Galvin was being tougher than Eliot Spitzer by forcing admissions of wrongdoing allegedly led Spitzer to declare "screw Bill Galvin!" at a conference held by the Society of American Business Editors and Writers in mid-2005. *See* Cosmo Macero, Jr., *Between Bouts, Spitzer Goes After Galvin*, BOSTON HERALD, May 4, 2005, at 30. The SEC's routine use of settlements allowing no admission of wrongdoing has come under increased scrutiny by courts in recent years, causing the SEC to make some minor modifications to its policy. *See* Andrew Ackerman, *SEC Modifies "Confirm nor Deny"*, WALL ST. J., Jan. 7–8, 2012, at B14. The policy issue is not clear cut, as admissions may be used against defendants in follow-on private litigation, and thus may frustrate the SEC's attempts to settle cases.

196. John Laidler, *Potential Gubernatorial Candidates Begin Wooing Area Voters: Democrats Eager to Retake Office*, BOSTON GLOBE, Mar. 10, 2005, at 4.

197. For instance, in 2011 West Virginia ranked 45th in the nation for GDP derived from finance and insurance. BUREAU OF ECON. ANALYSIS, U.S. DEP'T OF COMMERCE, REGIONAL ECONOMIC ACCOUNTS: GDP & PERSONAL INCOME (2011), *available at* http://www.bea.gov/iTable/drilldown.cfm?reqid=70&stepnum=11&AreaTypeKeyGdp=0&GeoFipsGdp=XX&ClassKeyGdp=NAICS&ComponentKey=200&IndustryKey=150&YearGdp=2011&YearGdpBegin=-1&YearGdpEnd=-1&UnitOfMeasureKeyGdp=Levels&RankKeyGdp=1&Drill=1&nRange=5. To obtain data on state GDP, see U.S. DEP'T OF COMMERCE, BUREAU OF ECON. ANALYSIS, http://www.bea.gov (last visited Mar. 12, 2012).

"piggyback" or "me, too" action filed in the wake of enforcement activity by other regulators. West Virginia's actions are discussed in more detail below, in Part IV.B.2.

e. Notable Absences

In evaluating the strength of the Vacuum Filling Hypothesis, it is also important to pay attention to what the data does not reveal. It does not reveal any enforcement activity by Delaware, despite the fact that Delaware is the state of incorporation of 58% of the companies in the dataset and owes 36% of its gross domestic product to the financial sector.[198] Nor does it reveal any enforcement activity by Texas, notwithstanding that more companies in the dataset are headquartered in Texas than any other state.[199] California is the most populous state and headquarters to 10% of the companies in the dataset, yet it was identified as having brought only one enforcement action.[200]

These facts, while notable, do not necessarily undermine the Vacuum Filling Hypothesis. It may be that the efforts of a single state are all that is needed to correct for federal underenforcement; if that is the case, New York's activity in this time frame may have relieved pressure on these other states to take action. It may also be the case that these states did not take action because they did not perceive the SEC to be underenforcing, or because they lacked resources. It is also possible that these states' enforcement incentives were compromised—for example, Delaware is frequently accused of being captured

198. *See* Rose & LeBlanc, *supra* note 148, at 479 (Table A.1). For a discussion of the possible reasons for Delaware's dominance in the "race" for corporate charters, see A.C. Pritchard, *London as Delaware?*, 78 U. CIN. L. REV. 473, 476–83 (2009).

199. *See* Rose & LeBlanc, *supra* note 148, at 483 (Table A.3).

200. California's efforts were at least slightly stronger than the dataset would suggest, however. California Attorney General Bill Lockyer took an aggressive (and controversial) stance in this time period on mutual fund marketing practices. The one action by California included in the dataset involved a case he brought against Franklin Resources related to this topic. *See, e.g.*, Tom Lauricella & Arden Dale, *Franklin Resources Nears Settlement*, WALL ST. J., Nov. 15, 2004, at C15. Lockyer also asserted similar allegations against other companies that were not in the dataset. *See, e.g.*, Tom Lauricella, *California Tackles Disclosure Issues at Mutual Funds*, WALL ST. J., Sept. 16, 2004, at C1 (noting that Lockyer's settlement with a mutual-fund company "essentially created a new requirement that fund companies disclose how much they pay brokerage firms to hawk their funds and which firms get the money").

by corporate managers who favor policies that are not in the best interest of investors or the capital markets more broadly.[201]

2. Rent Seeking

Whereas the Vacuum Filling Hypothesis casts NSMIA's fraud carve-out in a positive light, the Rent Seeking Hypothesis focuses on its negative potential. Consistent with the Vacuum Filling Hypothesis, state-led efforts can produce positive externalities when they fill enforcement gaps left by the SEC. But state-led efforts can also produce negative externalities when they target public firms that have already been disciplined by other authorities. Nothing formally prevents a state regulator from free-riding on the investigative efforts of the SEC, the private bar, or other state regulators by filing a follow-on suit to recover a quick fine for the state fisc, while adding little to the deterrence mix. Such activity creates deadweight social costs, but those costs are borne by the entire nation while the state alone enjoys the revenue from the fine.[202] One would hope that a general concern for the national welfare on the part of state regulators keeps this sort of strategic activity to a minimum.[203] To the extent it does occur, I predict that the responsible states would be particularly *in*sensitive to the health of the national capital markets and to the interests of public companies more broadly—thus internalizing little of the harm their actions would produce.

Evaluating this hypothesis is difficult, as it requires judgment about the value particular enforcement actions add to the nation's quest for optimal deterrence. It is hard to say, for example, whether the Connecticut and Massachusetts actions and investigations discussed above—which largely piled on the enforcement efforts of the NYAG and SEC—were beneficial or not. They may have made up for insufficiently vigorous enforcement by the other regulators who pursued the same companies. Even if they did not add value, however, it is unlikely that they were part of a systematic effort by Connecticut and Massachusetts to profit on the backs of the insurance and mu-

201. *See* Cary, *supra* note 67, at 668–70.

202. For example, it might make it more difficult for federal regulators to negotiate settlements with offending firms, or lead public companies to invest more than is socially optimal in fraud deterrence.

203. The background threat of federal preemption might also operate to suppress this behavior. *See supra* note 38 and accompanying text; *see also* Mathiesen, *supra* note 114.

tual fund industries, given the close ties the states have to those industries. Instead, they likely reflected attempts by individual regulators to appear involved in remedying abuses in those industries. I feel quite confident, however, suggesting that West Virginia's actions were not in the national interest.

West Virginia brought fourteen actions against twelve companies in the dataset; six involved allegations related to biased analyst research and eight involved market timing allegations. The research cases were filed by the West Virginia Attorney General (WVAG) after each of the targeted companies had negotiated a global research settlement with representatives from the SEC, NASD, NYSE and all fifty states—including West Virginia's Auditor, who is in charge of enforcing the state's securities laws.[204] The negotiated global settlement provided for wide-ranging injunctive relief and an unprecedented payment of $1.4 billion.[205] The WVAG nevertheless brought fresh claims against the settling defendants—based on allegations apparently cut and pasted from the defendant firms' settlement documents—under the West Virginia Consumer Credit and Protection Act (WVCCPA).[206] The WVAG contended that the defendants violated that statute each time they "acted improperly in connection with the underwriting, marketing, allocation and pricing of securities or in the issuance or publication of research reports, ratings or opinions that were based on the conflict of interest between research and investment banking"—with violations "believed to be in the hundreds of thousands" with "each punishable by a fine of $5,000."[207]

While challenges to legitimacy of these claims were winding their way through the West Virginia courts, the WVAG brought the market timing actions—again against a group of defendants that had already negotiated substantial settlements with the SEC and other regulators, again pursuant to the WVCCPA, again with allegations apparently cut and pasted from the defendant firms' settlement documents with other

204. Brief of Petitioners at 1–2, State *ex rel.* McGraw, Jr. v. Bear, Stearns & Co., 618 S.E.2d 582 (W. Va. 2005) (No. 32515) (on file with author).

205. *See* Press Release, N.Y. Attorney Gen., SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement to Reform Investment Practices (Dec. 20, 2002), http://www.ag.ny.gov/press-release/sec-ny-attorney-general-nasd-nasaa-nyse-and-state-regulators-announce-historic (describing the settlement's terms).

206. Brief of Petitioners, *supra* note 204, at 2.

207. *Id.* at 3.

regulators, and again seeking breathtaking fines.[208] Both sets of actions were dismissed after the West Virginia Supreme Court held that the WVCCPA does not apply to transactions involving securities.[209] The market timing cases, however, were then reasserted by the West Virginia Auditor under the West Virginia Securities Act—this time with a prayer that a $10,000 fine be imposed for each and every mutual fund prospectus the defendants sent into the state that failed to disclose the alleged abuses.[210]

It does not appear that West Virginia's actions had any redeeming social value. The misconduct they targeted had already been uncovered and aggressively pursued by other regulators by the time they were filed.[211] West Virginia authorities apparently did no significant independent investigative work, instead simply cutting and pasting passages from the defendants' publicly available SEC settlement documents into their complaints. The state's enforcement activity thus appears to have been nothing more than an opportunistic attempt to expropriate wealth from the targeted firms' public shareholders—a strategy NSMIA's fraud carve-out seemingly permits.[212] This sort of behavior increases the cost of being a public company to no good end. But, as noted above, West Virginia is not particularly sensitive to these costs. Thus, West Virginia's activity is arguably consistent with the Rent Seeking Hypothesis.

But a nagging question remains: Why don't more states engage in this sort of strategic behavior? West Virginia is not the only state with an understated interest in the health of our national capital markets. This strategy could be profitable for citizens in other states, as well. Yet there is no evidence of its broader use in the data. A closer look at the cases West Virginia brought suggests an answer to this puzzle. Every disclosed regulatory action brought by West Virginia against the companies in the dataset involved the use of private plaintiffs' attorneys as co-counsel to the state.[213] A widely reported practice has

208. *See* Tamiko Toland, *Janus, W.Va. at War over Timing, Late-Trading Razz*, MONEY MGMT. EXECUTIVE, May 23, 2005, at 1.

209. *See* State *ex rel.* McGraw, Jr. v. Bear, Stearns & Co., 618 S.E.2d 582, 587 (W. Va. 2005).

210. *See, e.g.*, Summary Order, In re Janus Capital Grp. Inc., Before the Securities Commissioner (W. Va. Aug. 30, 2005) (No. 05-1320).

211. *See, e.g.*, Toland, *supra* note 208 (noting that the SEC had already pursued action against the companies that West Virginia targeted).

212. See 15 U.S.C. § 77r(c) (2006).

213. Anthony Majestro of Powell & Majestro, PLLC served as a "special

developed in West Virginia whereby its Attorney General, Darrell McGraw, routinely doles out lucrative state litigation to private attorneys on a contingency fee-like basis.[214] The data suggest that the West Virginia Auditor has gotten into the game as well. Some charge that McGraw's use of private lawyers to pursue state litigation is designed to reward his political supporters.[215]

Although it is impossible to know the WVAG's motives, my research has produced facts that are consistent with this allegation. According to the National Institute on Money in State Politics (the "Institute"), lawyers and lobbyists as a group were the single largest contributor to the 2004 reelection campaigns of both the WVAG and the West Virginia Auditor.[216] Moreover, a search of the Institute's records revealed that partners at each of the six law firms that served as co-counsel to the state in the WVAG's research cases contributed in that year to the WVAG's own campaign and/or to the campaign his brother ran for reelection to the West Virginia Supreme Court.[217] It also re-

assistant attorney general" in the market timing cases. *See, e.g.*, Response to Petition for Appeal, Alliance Capital v. III (W. Va. June 26, 2006) (Appeal No. 06-064) (on file with author) (listing Majestro as counsel for the state). The following private attorneys were listed as counsel for the state in the research cases: Marvin W. Masters of Masters & Taylor, LC; Barry Hill and Teresa Clark Toriseva of Hill, Toriseva & Williams, PLLC; Rudolph L. DiTrapano, Joshua I. Barrett and Sean P. McGinley of DiTrapano, Barrett & DiPiero, PLLC; James Peterson and R. Edison Hill of Hill Peterson Carper Bee Deitzler, PLLC; Sol H. Weiss and Joel D. Feldman of Anapol Schwartz Weiss Cohan Feldman Smalley PC; and Chris Placitella, Lynne M. Kizis, and Jennifer Sarnelli of Wilentz Goldman & Spitzer. *See* Brief of Petitioners, *supra* note 204 (certificate of service).

214. *See, e.g.*, *AGs Gone Wild*, WALL ST. J., Nov. 13, 2007, at A24; *McGraw Has Taken Outside Counsel Idea to New Heights*, W. VA. REC., August 1, 2008; HANS BADER, COMPETITIVE ENTER. INST., THE NATION'S TOP TEN WORST STATE ATTORNEYS GENERAL 15–17 (Jan. 24, 2007), http://cei.org/pdf/5719.pdf.

215. *See, e.g.*, W. VA. CITIZENS AGAINST LAWSUIT ABUSE, SPECIAL REPORT: FLAUNTING LAWS YOU ARE CHARGED TO PROTECT: A CRITICAL LOOK AT FOURTEEN YEARS IN THE OFFICE OF ATTORNEY GENERAL DARRELL MCGRAW 6–7 (June 2007), *available at* http://www.wvrecord.com/content/img/f196361/CALAreport.pdf.

216. Nat'l Inst. on Money in State Politics, *Table 2: Top 15 Industries*, FOLLOW THE MONEY (last visited Mar. 12, 2013), http://www.followthemoney.org/database/StateGlance/candidate.phtml?c=66200 (candidate summary for Glen B. Gainer III) and http://www.followthemoney.org/database/StateGlance/candidate.phtml?c=66280 (candidate summary for Darrell McGraw).

217. *See generally* Nat'l Inst. on Money in State Politics, *Candidates*, FOLLOW THE MONEY (last visited Mar. 12, 2013), http://www.followthemoney.org/database/StateGlance/state_candidates.phtml?s=WV&y=2004 (providing campaign contribution data for West Virginia political candidates). The same is

vealed that the private attorney hired in the market timing cases contributed to the 2004 campaigns of the WVAG, his brother, and the West Virginia Auditor.[218] Thus, I view West Virginia's activity as consistent with both the Rent Seeking Hypothesis and, perhaps even more so, the Political Entrepreneur Hypothesis.

3. Cooperation

Unlike the first two hypotheses, the third hypothesis casts aspersions on neither the SEC nor the states. Instead, it views their relationship as potentially symbiotic and cooperative, positing that state securities regulators may take action against public companies when they are better positioned to do so than the federal government, thus efficiently sharing the enforcement burden. If the states and federal government were acting cooperatively, one would not expect to see them targeting the same firms for the same misconduct. Instead, one would expect only one regulator to take the enforcement lead. One would also expect states to target firms that they have some special connection with, or to focus on misconduct that bears some special relationship to the state, as these factors would suggest that the state may enjoy an enforcement advantage relative to federal regulators.

The vast majority of the state investigations and actions disclosed by the companies in the dataset do not appear to support the Cooperation Hypothesis. This is because 91% involved overlapping investigations by the federal government (93 out of 102). Rather than cooperation, many of these cases involved open hostility between state and federal regulators—most notably between the NYAG and the SEC.[219] Moreover, only 32% of the ninety disclosed state actions and investigations that were attributable to particular states were brought against companies incorporated or headquartered in the enforcing state.[220]

While these facts suggest that the Cooperation Hypothesis may not have significant explanatory power, a more sympathetic reading of the data is possible. First, the nine actions that

true of all but one (Jennifer Sarnelli) of the individual attorneys identified in footnote 213 as representing the state.

218. *Id.*

219. *See, e.g.*, Tom Lauricella et al., *Mutual Funds Face Overhaul as Spitzer and SEC Fight for Turf*, WALL ST. J., Oct. 31, 2003, at A1; Dean Starkman & Carrie Johnson, *Loss of Coordination: Spitzer and Federal Officials Pursuing Insurance Probe Separately*, WASH. POST, July 19, 2005, at D1.

220. *See* Rose & LeBlanc, *supra* note 148, at 475–76.

did not involve an overlapping federal investigation lend the hypothesis limited support. These non-overlapping actions include some cases where state regulators may have enjoyed an enforcement advantage relative to federal enforcers due to their relationship to the company or the alleged misconduct. Moreover, I cannot rule out the possibility that there was an efficient division of labor between federal and state regulators in connection with some of the overlapping investigations disclosed in the dataset. I do know that the state regulatory actions involving biased analyst research that were *not* brought by West Virginia involved a level of coordination between state and federal regulators,[221] although New York's initial investigation into analyst conflicts of interest was not a cooperative effort with the SEC.

Moreover, a state may have a special connection to the firm or misconduct even if the target of the investigation is not headquartered or incorporated there. I therefore reexamined the data taking a more generous view of "special connection." In addition to counting a state action as having a special connection to the target if the target was incorporated or headquartered there, I counted it as "specially connected" if the misconduct at issue bore some obvious relationship to the state. For example, I counted as connected suits by South Carolina and Georgia against A.G. Edwards, as they involved misconduct in the firm's Augusta branch, affecting residents in both those states. I also, for example, counted as connected New Jersey's market timing investigation into Merrill Lynch, as the misconduct involved a team in the firm's New Jersey office. In addition, I counted as connected all of Connecticut's actions and investigations related to finite insurance, and all of Massachusetts' actions related to market timing and mutual fund marketing issues, given the special relationship those states have to the insurance and mutual fund industries, respectively. Taking this more generous view of "special connection," I would classify forty-nine of the ninety (54%) state actions and investi-

221. Press Release, SEC, SEC Launches Inquiry into Research Analyst Conflicts (April 25, 2002), http://www.sec.gov/news/press/2002-56.htm (announcing coordinated investigatory effort between the SEC, NASD, NYSE, NYAG and nine other states. Six of the nine state regulatory actions or investigations involving biased research allegations disclosed in the dataset were brought by West Virginia; the other three were brought by New York (2) and Utah (1)).

gations that were attributable to particular states as bearing some special connection to the enforcing state.[222]

4. Political Entrepreneurs

The Political Entrepreneur Hypothesis is more broadly consistent with the data than any other single hypothesis I examined. The Political Entrepreneur Hypothesis focuses on the motivations of state enforcers, positing that they will utilize NSMIA's fraud carve-out to pursue public companies if they stand to benefit personally by doing so. To be sure, state regulators benefit (one hopes!) when they perform their job in a manner that promotes the welfare of their individual state and, perhaps, the nation more broadly. If that is what was meant by personal benefit, however, this hypothesis would add nothing to those already discussed. The focus instead is on distinctly personal benefits.

I posit that elected regulators in particular stand to reap personal benefits from pursuing public companies for securities-related misconduct. Going after a public company can garner media attention that alerts citizens to the regulator's enforcement efforts. This publicity can help elected regulators get reelected. It can also help propel them to higher office, something that elected regulators may care more about than their appointed counterparts if we assume the former are more politically ambitious. As the West Virginia actions demonstrate, under certain circumstances pursuing public companies can also provide elected regulators with an opportunity to reward their political supporters. The foregoing logic leads to the prediction that elected state regulators will utilize NMSIA's fraud carve-out more often than appointed state regulators.

The dataset provides compelling quantitative evidence in support of this hypothesis. Just 36% of states have an elected official in charge of securities enforcement.[223] But these states were responsible for 80% of the disclosed matters attributable to particular states.[224] A regression, controlling for other variables that might influence a state's level of enforcement intensity, revealed a statistically significant relationship between the elected status of the enforcer and the number of enforcement

222. It is of course possible that other actions bore some special connection to the enforcing state that the author was unable to observe.

223. *See* Rose & LeBlanc, *supra* note 148, at 457 n.28 (explaining how enforcers were classified).

224. *Id*. at 469 (Table 7).

actions brought. Specifically, states with elected enforcers brought actions at over four times the rate of states with appointed enforcers.[225]

A separate regression with similar controls was run, which tested for the effect of having an elected Democrat as the state's primary securities enforcer.[226] The theory underlying this modification is that because the White House and SEC were controlled by Republicans in the time frame examined, elected Democrats would have the most to gain by being active and demonstrating to voters that they are tougher on fraud than their political foils in Washington. The results of this second regression revealed that states with elected Democrats brought actions at nearly *seven times* the rate of other states, a result that was highly statistically significant.[227]

A qualitative look at the individuals disclosed by the dataset to be the most active enforcers—NYAG Eliot Spitzer, Connecticut Attorney General Richard Blumenthal, Secretary of State William Galvin, and WVAG Darrell McGraw, all elected Democrats—adds further color to this hypothesis. The possible political motivation of WVAG McGraw—namely, to use enforcement actions against public companies as a means of rewarding political supporters—has already been discussed.[228] It differs from the possible political motivation of the other three men—namely, to leverage publicity generated by their enforcement actions to aid in future political pursuits. Focusing on these three, it is interesting to note that not only was each an elected Democrat during a Republican presidential administration, but each man also served a state with a Republican governor and was reported during the time period to have gubernatorial ambitions.[229] Thus, the investigations and actions

225. For full regression results, see id. at 493 (Table A.12).

226. *See id*. at 467 n.52 (explaining how party affiliation was determined).

227. *Id.* at 447–48, 472 (referring to results reported in the Appendix at Table A.13).

228. *See supra* Part IV.B.

229. Spitzer was the only one to realize his ambition, succeeding George Pataki as governor of New York in 2006—before a spectacular fall from grace in 2008. *See* Josh Getlin, *Spitzer Reveals Plans to Run for N.Y. Governor*, L.A. TIMES, Dec. 8, 2004; *see also* Danny Hakim & William K. Rashbaum, *Spitzer, Linked to a Sex Ring as a Client, Gives an Apology*, N.Y. TIMES, March 11, 2008, at A1. Blumenthal did not end up pursuing Connecticut's governorship, instead holding on to his post as Connecticut Attorney General through 2010, when he successfully ran for U.S. Senate. *See Connecticut: Malloy Elected First Dem Governor in Two Decades*, USA TODAY, Nov. 3, 2010, http://usatoday30.usatoday.com/news/politics/2010-11-02-ct-full-election-

these men brought did not merely offer a way to get their name mentioned in media reports, but also provided a way for them to position themselves in the eyes of voters as more aggressive on financial fraud than their Republican foils at both the federal *and* state levels.[230]

It is important to recall that the Political Entrepreneur Hypothesis, unlike the other three hypotheses, does not speak directly to the social value of NSMIA's fraud carve-out. Enforcement activity undertaken for selfish purposes may, as in the West Virginia actions, be inimical to the public good. But a selfish desire for reelection or political advancement may also lead regulators to undertake actions that are in the nation's best interest, as may arguably have been the case with respect to New York's enforcement activity.

C. Implications for Reform

The evidence discussed above is not definitive enough to answer whether concurrent state enforcement has done more good than harm in the securities context. But it does reveal that concurrent state enforcement has produced both social costs and benefits, even if those costs and benefits cannot be quantified and weighed against one another with precision. The question is therefore raised: Are reforms possible that would preserve state enforcement's beneficial manifestations while minimizing its negative permutations, thus leading to social welfare gains?

Based on the data, calls to eliminate NSMIA's fraud carve-out in its entirety are dubious, at least absent simultaneous reforms designed to improve the functioning of the SEC (or more convincing evidence of the SEC's efficacy as a stand-alone enforcer). New York's activity in particular suggests that state enforcement has operated to discipline a flagging SEC, and may do so again. But the data also suggest that the carve-out as it currently exists is too broad, for it indiscriminately grants any (and all) states authority to pursue public companies for securities-related misconduct, regardless of the state's motivation—

results_N.htm. Galvin likewise chose not to run for governor, but retains his post as Massachusetts Secretary of State to this day. Seth Gitell, *Waiting in the Wings*, BOS. PHOENIX (Mar. 8, 2001), http://www.bostonphoenix.com/boston/news_features/talking_politics/documents/00670492.htm.

230. *See* Macey, *supra* note 134, at 958 (observing that "Mr. Spitzer did not mount his initiative to regulate the securities markets (and along the way to politically embarrass the SEC and the administration) until his political party had lost control of the White House to the Republicans").

thus permitting the type of rent-seeking behavior exemplified in the dataset by West Virginia.[231] A narrower carve-out might help separate the wheat from the chaff.

For example, policymakers might consider limiting the carve-out's application to (1) New York and (2) to states that can demonstrate a special connection to the targeted company or the misconduct at issue. New York's privileged treatment may be warranted due to its unique sensitivity to the health of the national capital markets, which makes it particularly well-suited to play watchdog to the SEC. Singling out a state for exemption from federal preemption would not be unprecedented: California has a similarly exalted status in the environmental arena.[232] Requiring other states to meet the heightened jurisdictional test would reduce the likelihood of purely opportunistic enforcement, without restricting those states most likely to have appropriate enforcement incentives—and most likely to bring to the table the sort of local advantages typically associated with concurrent enforcement. While reducing the number of states with concurrent jurisdiction would make it marginally easier for special interests desiring under-enforcement to capture all enforcers, under this proposal, several states (though substantially less than fifty) would likely retain enforcement authority in any given case. Furthermore, the states most prone to capture by interest groups desiring *over*-enforcement would be appropriately disempowered.[233]

To be sure, preserving the ability of even this more limited set of states to police public companies for securities-related misconduct carries risks. Concerns have been voiced that politically ambitious state regulators sometimes go too far in their efforts to show up the SEC and can force companies into accepting settlements with pernicious market-wide effects. This is a charge that many leveled against Eliot Spitzer during his ten-

231. *See also* Christopher R. Lane, *Halting the March Toward Preemption: Resolving Conflicts Between State and Federal Securities Regulators*, 39 NEW ENG. L. REV. 317, 339 (2005) (asserting that "Oklahoma . . . dropped criminal securities fraud charges against WorldCom in return for a promise by the company to create 1600 jobs in the state over the next ten years").

232. *See* AM. BAR ASS'N, *supra* note 4, at 280 (explaining California's special authority to set motor vehicle emissions standards under the Air Quality Act of 1967).

233. Another possibility would be to extend the ban on federal agencies' use of private counsel on a contingency-fee basis to state securities regulators exercising their preserved authority under NSMIA. *See supra* note 139.

ure as NYAG.[234] Some scholars have, therefore, proposed legislation that would authorize the SEC to invalidate an order or settlement reached by a state securities regulator that in the SEC's view "unreasonably restrained competition, interfered with fair and orderly markets, impeded the national market system, or was otherwise contrary to the public interest or the protection of investors."[235]

The fact that elected Democrats brought securities-related matters against the companies in the dataset at over seven times the rate of other enforcers[236] does seem to suggest that there is a political dimension to a state's decision to pursue public companies for securities-related misconduct. And allowing generalist state enforcers with political motivations to make decisions affecting national market structure is concerning, as it undermines the public policy goals animating the SEC's design as a politically insulated, independent agency. But the data simply cannot answer whether granting the SEC this type of veto authority would be beneficial or not. It is at least possible that a captured SEC would abuse the authority,[237] or that its mere existence would dampen state interest in filling federal enforcement vacuums in the first place.

234. *See, e.g.*, *supra* note 174 (discussing the rate-setting aspect of Spitzer's market timing settlement with Alliance); Langevoort, *supra* note 34, at 891 ("The dangers of state criminal prosecution, especially on the fairly loose standards of something like New York's Martin Act, are disabling enough to give prosecutors leverage on matters of industry conduct that those in the industry would otherwise resist. Local state-level politics should not determine basic policies in the securities industry. Thus, Congress always has a principled argument for removing particular matters from state authority."); Cassidy, *supra* note 112 at 54, 56 (discussing Spitzer's initial plan to call for a complete separation of analysts from investment bankers as part of his research settlements); *see also* Allan Chernoff, *WorldCom Case Ignites Turf Battle*, CNN.COM (Aug. 27, 2003), http://edition.cnn.com/2003/BUSINESS/08/27/us.worldcom/index.html (discussing the federal government's complaint that Oklahoma's prosecution of WorldCom could "impede and delay the administration of justice" in parallel federal proceedings).

235. John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea*, 95 VA. L. REV. 707, 780 (2009); *see also* COMM. ON CAPITAL MKTS REGULATION, *supra* note 99, at 68–69 (recommending the SEC be given final say on settlements negotiated by state regulators when they involve structural remedies concerning matters of national importance).

236. *See supra* note 227 and accompanying text.

237. Although, as Professors Coffee and Sale point out, the publicity that would surround a veto decision would discourage such behavior. Coffee & Sale, *supra* note 236, at 781. I have similarly proposed that the SEC should be given veto authority over Rule 10b-5 class actions, though under my proposal the SEC would act at the beginning rather than the end of the litigation. *See* Rose,

A set of more modest—and politically feasible—reforms could be imagined that would help quell state overreaching, as well as increase the overall efficiency of the U.S. securities fraud enforcement regime. For example, a state regulator utilizing his or her preserved authority under NSMIA might be required to simultaneously send a copy of any subpoena, request for information, or other discovery demand it issues in connection with an investigation of a public company to the SEC's Division of Enforcement. States might also be required to report to the SEC in advance their intention to initiate formal enforcement proceedings against a public company and any plan to resolve such proceedings through settlement, as well as the basis for their decision.[238]

These requirements would not impose significant burdens on state regulators, nor disrupt the potential for states to act as a counterweight to a captured SEC. But by fostering communication early on and throughout the investigative process, they may lead to greater cooperation and coordination between state and federal regulators than was evidenced in the state actions disclosed in the dataset. If the SEC, for example, believed that a proposed course of action by a state regulator was misguided, the envisioned notice requirements would give it the opportunity to convince the state regulator of the legitimacy of its view or, if that failed, to take its case to the media or Congress.[239] As noted in Part II.B.4, these sorts of requirements are common in concurrent enforcement regimes involving federal law, and

supra note 99, at 1358 (explaining how transparency and accountability could be built into such a regime).

238. Others have made narrower recommendations in a similar vein. *See, e.g.*, Lane, *supra* note 231, at 320 (arguing that states should be required "to notify and consult with the SEC in the event they seek to enact remedies that would have a nationwide impact").

239. The notion that a politically ambitious state regulator would be open to persuasion by the SEC may seem Pollyannaish, but even Eliot Spitzer was talked down on occasion from some of his more grandiose ideas. *See, e.g.*, Cassidy, *supra* note 112, at 71 (observing that Spitzer, in connection with his investigation of biased analyst research at large Wall Street brokerage houses, abandoned his initial call for a complete separation of analysts from investment bankers, thus showing "himself more willing to compromise than many people on Wall Street had anticipated"); *see also* Patrick O'Gilfoil Healy, *Spitzer, In A Shift, Will Yield Inquiries to U.S. Regulators*, N.Y. TIMES, Dec. 25, 2004, at A1 (recounting that Spitzer, after announcing his bid for governor of New York, decided to cede his investigations to federal regulators, stating "he was concerned that 50 different investigations would balkanize regulations, and add[ing] that once-lax federal agencies had become more aggressive about rooting out fraud and wrongdoing").

there is no good reason why similar safeguards should not exist in this context.

A bolder initiative that would dampen the ability of state enforcers to distort federal policy would be to preempt state securities fraud laws as applied to nationally traded firms, while granting state enforcers authority to enforce federal fraud prohibitions.[240] As discussed in Part II.B.2, preserving just a state enforcement role may be more important in checking federal enforcement laxity than preserving a state lawmaking role, and it would limit the ability of states to undermine national goals through aberrant statutes such as the Martin Act.[241] Meanwhile, states could still leverage local resource- and knowledge-based advantages, as well as provide an additional outlet for citizen influence. While less politically feasible than the other structural reforms mentioned above, this proposal warrants further consideration.

The goal here is not to provide concrete policy prescriptions, but rather to stimulate a conversation on how the concurrent state-federal securities fraud enforcement regime might be made more effective.[242] The empirical evidence described above makes clear that room for improvement exists, and thus invites policymakers to consider the possibility of incremental reforms.[243]

240. This approach would be easier to administer than preempting state securities fraud laws only if, and to the extent that, they diverge from federal law, as some have advocated. *See, e.g.*, Securities Fraud Deterrence and Investor Restitution Act, H.R. 2179, 108th Cong. (2003); Steve A. Radom, *Balkanization of Securities Regulation: The Case for Federal Preemption*, 39 TEX. J. BUS. L. 295, 319–20 (2003).

241. *Supra* Part II.B.2.

242. Among other things, further thought should be given to the potential unintended consequences of the mentioned reforms. Would early notice requirements, for example, lead to more reasoned enforcement policy as suggested above, or instead provoke a potentially undesirable enforcement response by an SEC afraid of being overshadowed? *Cf.* Stephen Choi et al., *Scandal Enforcement at the SEC: The Arc of the Option Backdating Investigations* 4, 32 (N.Y.U. Law & Econ. Research Paper, Working Paper No. 11-20, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1876725 (finding empirical support for the hypothesis that the SEC pursued more marginal investigations into options backdating as the media frenzy surrounding that scandal persisted, at the expense of pursuing other more egregious securities law violations).

243. As I have argued elsewhere, consolidating enforcement authority in a single federal regulator should also be considered, but only alongside "reforms to align the federal enforcer's incentives more closely with the public interest (so as to offset any increased risk of under-deterrence this change might introduce)." Rose, *supra* note 24, at 2228.

CONCLUSION

Concurrent state-federal enforcement regimes should be neither celebrated nor lambasted in the abstract. Such regimes can create important benefits as well as produce significant costs. To determine whether they do more good than harm, or vice versa, requires an examination of the regulatory context. Such an examination demands more, however, than an ad hoc—and potentially outcome driven—weighing of amorphous costs and benefits. This Article has offered the tools needed to conduct such an examination in a disciplined way, allowing scholars to draw principled distinctions between concurrent enforcement's value in disparate legal settings. It has identified the contextual factors that influence the magnitude of the costs and benefits potentially produced by concurrent enforcement, including the reason for federal regulation, the breadth of the substantive prohibition being enforced, whether states are enforcing federal law or analogous state laws, the number of states with overlapping jurisdiction, and the type of safeguards built into the concurrent enforcement regime. It has also highlighted the need for empirical research to better understand how both federal and state enforcers can be expected to use their enforcement authority—which, at the end of the day, is key to determining concurrent enforcement's desirability. To illustrate these points, this Article has provided a detailed—and empirically grounded—case study of concurrent enforcement of securities fraud laws against nationally traded firms. While that case study cannot answer definitively whether concurrent state enforcement in the securities fraud context is desirable, it does reveal that state enforcement has produced both social costs and social benefits, and supports nuanced reforms likely to improve the efficacy of the enforcement regime going forward.