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THE 16TH SOKOL COLLOQUIUM: THE PRIVATIZATION OF SECURITIES LAWS: Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis

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SUMMARY:

... Three recent articles have rekindled a long-running academic debate on whether to devolve (or privatize) securities regulation. ... In my view, the case for devolution is weaker than has been appreciated because of the large degree of private choice of securities regulation already available to issuers, as well as the extent to which even the most full-blown of the SEC's disclosure requirements are tailored by the issuer to itself and to the issue. ... To the extent that private capital markets in the United States represent an attractive alternative to European issuers wishing to raise capital in the United States, the claim that issuers retain substantial choice over securities regulation even when selling to U.S. investors is that much stronger and the advantages for devolution that much weaker. ... Given that the marginal effect of additional costs associated with mandatory disclosure would principally affect small issuers, the fact that the SEC has already substantially lessened that burden by tailoring its rules based on firm size again argues that the net benefits of devolution and regulatory competition are likely overstated. ...

TEXT:

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Introduction

Three recent articles n1 have rekindled a long-running academic debate on whether to devolve (or privatize) n2 securities regulation. Devolution has a simple theoretical appeal: by replacing the Securities and Exchange Commission's (SEC's) "regulatory monopoly" with regulatory competition, devolution promises to improve the "regulatory product" as competitive markets improve ordinary products for consumers. Other academics have joined the debate, arguing that market failures stemming from asymmetric information, regulatory externalities, and network externalities would create a race to the bottom, making the devolutionary cure worse than the disease. n3 Symposia on devolution are multiplying; n4 and among academics, at least, the devolutionary theme has been spreading.

[*533] My perspective on this topic diverges from the debate so far: I begin by examining whether lobbying of devolution's intended beneficiaries shows that they would prefer devolution, and (at least initially) to take my lead from them. What can we infer from the behavior of direct intended beneficiaries of devolution? If asked this question, advocates of devolution would face a puzzle. Corporate America n5 does not seem to have much interest in devolution. Good companies - which, if devolution advocates are right, would be able to sell stock at a lower net cost if devolution were enacted - are not, to put it mildly, in the vanguard of the renewed assault on the SEC. In fact, industry trade groups have been supporting movement in the opposite direction, towards increased centralization of disclosure regulation at the domestic level, and harmonization of disclosure rules by agreement among national regulators at the international

level. n6 This is true not simply of securities lawyers and other market professionals, who may have a vested interest in maintaining the existing regime regardless of the long-term interests of their clients, n7 but also of trade groups representing small business, venture capital, technology companies, and financial executives. n8 What explains industry's indifference (or even resistance) to devolution?

The theory of this essay is that indifference to devolution on the part of corporate America has as much to do with politics as with the theoretical merits of either regulatory competition or monopoly. More precisely: the merits of the devolution proposals cannot be evaluated without considering politics. By politics, I mean not simply an assessment of the political costs of achieving devolution in the first instance, although those costs are likely large, but [*534] rather, I also mean a comparison of the political benefits of the current regime with the long-run political risks of devolution to industry participants. To make that comparison, at least two things are needed: first, an appreciation of the political economy of the SEC under the current regime; and second, an expected political economy of securities regulation under likely future macroeconomic and financial conditions. To fully evaluate devolution, both elements of this political cost/benefit calculus must be added to the economic one.

Although a full political cost/benefit analysis of federal securities regulation would be well beyond the scope of this essay, I take two steps here toward that end, by describing two ways that the current regulatory structure may be more attractive to corporate America than devolution proponents acknowledge: (1) the existing system is far from a "one size fits all" Mao jacket as devolution proponents have made out, which suggests that the SEC is now at the center of a relatively stable political equilibrium with significant practical advantages for industry; and (2) even if devolution produced net benefits in the short run, it is unlikely to be politically stable and, on a risk-adjusted basis, could be politically inferior to the current system. The first point is not new, but I put the point to a somewhat different end than others. n9 In my view, the case for devolution is weaker than has been appreciated because of the large degree of private choice of securities regulation already available to issuers, as well as the extent to which even the most full-blown of the SEC's disclosure requirements are tailored by the issuer to itself and to the issue. Evidence on the diminishing significance of barriers imposed by the current U.S. securities regulatory system to capital-raising is reviewed in partial support of these claims. An appreciation of private choice and tailoring, and a fair account of the SEC's responsiveness to industry preferences and the durability of the current regime through many crises, provide one-half of the political picture. Economic theories of regulation help explain why the current regime holds many advantages that issuers would be wise to retain.

The second point is necessarily more speculative, but is new, at least as applied to securities regulation, and seems no more [*535] speculative than the "educated predictions" made in favor of devolution. n10 As currently proposed, sweeping devolution would be politically unstable. n11 My argument for this second point proceeds in steps. I first sketch an informal model of how securities regulation in the United States developed, drawing on the history of the existing federal securities laws. In particular, I argue that federal securities laws reflect (1) issue-entrepreneurs and politicians willing and able to exploit predictable financial crises and economic downturns to private advantage, (2) general popular suspicion in the United States of concentrated and secret power, particularly on Wall Street, and (3) deep and probably permanent uncertainty about the merits of federal disclosure regulation. I then argue that should devolution succeed in the short-run, the odds are high that re-regulation n12 will follow, regardless of what a politically neutral policy analyst might think about the merits of re-regulation. I then briefly consider the circumstances under which re-regulation would occur (e.g., recession, crash, scandal), and note the political risks that having regulation of corporations generally on the public agenda might pose to corporate America under those circumstances. Finally, I argue that a reduction of the political power of the SEC - a consequence of the devolution proposals - would further increase the political risks associated with re-regulation.

Together, these two points - that devolution's political benefits are smaller and its potential costs larger than previously appreciated - are a first approximation of an explanation for the failure of corporate America to take up the devolutionary banner. The direct potential beneficiaries of securities regulation devolution do not perceive the effort to be worth the potential costs. This explanation has different implications than conventional critiques of devolution. For public-spirited policy analysts inclined to support devolution, more thought needs to go into how devolution could be protected from re-regulation in times of financial crisis, into how the high political costs of politically "hardening" any devolution [*536] of securities regulation might be reduced through new forms of feasible collective action, and how to address popular suspicion of concentrated wealth and power in the private sphere. n13 A possible, if speculative, response to the political risks raised by devolution is to try to achieve the benefits of regulatory competition without incurring all of the costs, by retaining federal regulation of securities but establishing some form of competition among federal regulators, as currently exists in part in the sphere of banking regulation. n14 Finally, the analysis suggests that trends toward increased "harmonization" at the international level may be desirable for reasons having nothing to do

with benefits customarily ascribed to it (at least in public): scale economies or benefits of standardization. Instead, harmonization may be attractive because (as is also true in the case of banking regulation) it will generate a respected, politically effective securities regulatory body that is expert or "captured" or both, and which may serve to protect industry interests by playing political roles in the international arena similar to those played by the SEC domestically.

I. Proposals for Devolution and the Industry Response

A. Overview of Proposals

Although the various devolution proposals differ in details, each would shift authority to regulate disclosure away from the SEC to multiple regulators. n15 Romano would give the states the power to set their own disclosure standards, which (if issuers chose) would in a sort of reverse preemption, take the place of SEC regulation. Mahoney would give that power to the stock exchanges, and Choi and Guzman would allow an issuer to choose any government, [*537] domestic or foreign, to be its global securities regulator, regardless of where purchasers of the securities resided. Each thus would eliminate the SEC's regulatory "monopoly," introducing competition into the regulatory process. Issuers would be able to choose from among different regulatory regimes, and because each devolution proponent assumes or argues that investors would be able to understand, evaluate and thus "price" the different available regulatory regimes, issuers would have an incentive to choose the best regulatory and disclosure rules. Promised benefits include improved regulatory incentives, reduced absolute levels of regulatory power, and - since more than one set of regulations would be available to any given issuer - more tailoring of different disclosure rules (and thus disclosures) to different issuers.

B. Why Industry Indifference?

To date, industry has not embraced devolution. I have been unable to find any industry-based trade or lobbying organizations that typically comment publicly on SEC proposals, or sponsor legislation in Congress, that have publicly endorsed or even favorably commented on the devolution proposals. Nothing on devolution was discovered in a search of the publications and websites of organizations representing small businesses (U.S. Chamber of Commerce, National Association of Independent Businesses, and the Small Business Survival Committee), venture capital funds (National Association of Venture Capital), technology companies (American Electronics Association, Software Publishers Association, Information Technology Association of America), mature companies (Business Roundtable, National Association of Manufacturers, Financial Executives Institute), and institutional shareholders (Teachers Insurance and Annuity Association and College Retirement Equities Fund [TIAA-CREF], California Public Employees' Retirement System [CalPERS], State of Wisconsin Investment Board [SWIB]). Indifference to devolution cuts across all sectors of the capital sector. Industry interests are not homogenous on every securities law issue, but on devolution, there is no sign of tension among business interests. n16

[*538] In fact, corporate America has to date implicitly rejected devolution by supporting increased degrees of central regulation, both within the United States and internationally. Within the United States, the National Securities Markets Improvement Act of 1996 (the "1996 Act") n17 expanded the degree to which federal securities laws preempt state laws governing disclosure, and rejected the limited degree of devolution that had been embedded in the securities laws since they were enacted in the New Deal. Centralization of jurisdiction over securities law proceeded further in the Securities Litigation Uniform Standards Act of 1998 (the "1998 Act"), n18 after corporate America (and then their supporters in Congress) began to worry that their efforts to rein in private lawsuits under the federal securities laws were being circumvented in the state courts. As Romano notes, "the current legislative approach to securities regulation" is proceeding in the opposite of the devolutionary direction she advocates - industry advocates, in other words, are making what she believes is "a mistake." n19 What she does not expressly acknowledge is that this centralizing tendency has been pursued largely at the behest of the very individuals and organizations who would be most directly affected by the results of successful devolution, and who would be most directly benefited if devolution were to reduce the expected long-run cost of equity capital. n20

[*539] At the international level, as well, U.S. industry organizations have gone on record as advocating that securities disclosure regulation be "harmonized" (read: "centralized by agreement among national securities regulators"). The U.S. organizations that most plausibly represent informed industry opinion on the merits of securities law proposals do not advocate imposing U.S. Generally Accepted Accounting Principles (GAAP) on the rest of the world, and instead support adoption of international accounting standards (IAS) as the international norm. However, they do not support devolution (which would reduce harmonization). The Business Roundtable, for example, argues in its publications that "the SEC is the [world] leader in diligent enforcement ... [and] absent this "strong arm," the quality and strength of the U.S. capital markets would dissipate," and accordingly, "would support the development of worldwide enforcement

standards." n21 The Financial Executives Institute (FEI), a "professional association for senior financial executives representing 15,000 individuals from over 8,000 corporations throughout the United States and Canada," takes the position that it would be "in our best interests to help foster an environment in markets outside the United States that favors accounting standards that rely on an investor-oriented framework like IAS." n22 As it has within the United States, corporate America thus far seems to be embracing not devolution in the international sphere, but its opposite.

Among possible explanations for inaction on the part of corporate America is that it simply lags securities law academics on understanding sweeping, intellectually complex issues. Perhaps business leaders will eventually awaken to the prospect of additional profit that devolution offers. Such an account strikes me as naive. The willingness of these executives to engage zealously in innovative federal securities law reform repeatedly in the 1990s illustrates the basic economic wisdom that profit opportunities stimulate thought and activity. Romano's proposal has received attention in prominent general-circulation publications such as the *Economist*, and all of the devolution proposals have now been in circulation [*540] for several years, receiving widespread attention among academics. n23 Nor is it the case that privatization and devolution of disclosure regulation are new ideas. Stigler questioned the value of the federal securities statutes as early as 1964, n24 and Benston and Kripke attacked federal securities regulation in prominent publications in the 1970s. n25 Failure to take up the devolutionary cause to date is not plausibly due to a "lack of imagination," as Romano asserts. n26

Another possible explanation is that corporate America faces classic collective action problems: gains from devolution might be large in the aggregate, but small spread among many thousands of potential beneficiaries, while the costs of devolution advocacy will fall fully on first-movers and not on free-riders. n27 Again, however, the ability of industry representatives to overcome these problems and enact three major pieces of federal securities legislation in the [*541] Private Securities Litigation Reform Act of 1995 (the "1995 Act"), n28 the 1996 Act and the 1998 Act, each against strong opposition from organized political interests, suggests otherwise. The Small Business Investment Incentive Act of 1980, adopted largely at the behest of the venture capital community and (after modifications) supported by the SEC, raised the small offering exemption in Section 3(b) of the 1933 Act from \$ 2 million to \$ 5 million (subsequently reflected in the SEC's Regulation D) and loosened the Investment Company Act of 1940 and the Investment Advisers Act of 1940 as they applied to venture capital funds. n29

Industry organizations frequently engage in costly lobbying of Congress and the SEC, to promote (or oppose) changes that are potentially less important than devolution, but just as general. These changes should produce the same kind of broadly distributed but small net effect for industry as devolution. If collective action problems were serious, lobbying for such changes should not occur, but it does. Each of TIAA-CREF, CalPERS and SWIB, for example, has submitted comment letters backing the SEC's proposed auditor independence rules, and would go even further to limit the scope of services auditors may provide. n30 The Chamber of Commerce, on the other hand, has ongoing lobbying efforts to stop the SEC from forcing the accounting firms to split their consulting and auditing businesses, as well as to pass federal legislation that follows up on the 1998 Act to move all class actions from state to federal courts. n31 The Business Roundtable is engaged [*542] in ongoing lobbying to "streamline and simplify SEC regulations," and to prevent the SEC from adopting a proposal to require disclosure of detailed litigation-related loss accruals on the ground that the rule "could severely limit [an issuer's] ability to manage ... its litigation." n32 The FEI contributed to the effective lobbying effort against the SEC's "Aircraft Carrier" proposal, and is engaged in ongoing lobbying of the International Accounting Standards Committee (IASC) regarding the selection process for new members of the board of the IASC. n33

Thus, while it is possible that collective action problems create divergence between the willingness of industry organizations to pursue every theoretically optimal modification to securities regulation, it seems unlikely that these problems can explain industry's decision to ignore or oppose devolution. A more likely explanation is that industry representatives have evaluated devolution and found it wanting on its merits. As devolution advocates admit, one must expect devolution to produce materially better regulations before it would be worth the costs of transitioning to a new system. And it may be that regulatory competition does not promise much improvement over the status quo, because the status quo already provides issuers with sufficient private choice.

II. Private Choice of Securities Regulation Under Existing Laws

Advocates of devolution often assert or imply that the current U.S. securities regime imposes a "one-size-fits-all" set of rules on issuers. Choi and Guzman argue that regulatory competition would allow issuers to choose from a "diverse set of national regulations," whereas the current U.S. regime requires issuers [*543] selling securities into the United States to "comply with one of the most rigorous and expensive regimes in the world." n34 Romano contrasts a federal

"default regime," giving companies the right to "opt out" of federal securities laws, with the "present one-size-fits-all regime," and compares the existing system of state corporate law with "a monopolist-regulator enforcing one national corporation law." n35 To support devolving disclosure regulation to the stock exchanges, Mahoney argues that "governmental regulators ... can create a uniform set of rules." n36

In fact, however, existing law provides for far more issuer choice about the level and nature of securities disclosure regulation than devolution proponents have acknowledged, as detailed in Part II-A. As Palmiter writes, "issuers can now choose from among a richly-layered set of disclosure levels and methods in offering their securities to public investors." n37 Moreover, as shown in Part II-B, even under the most full-blown disclosure regime imposed on domestic public companies, the SEC's current rules provide not a single set of requirements (i.e., one-size-fits-all), but numerous flexible and open-textured disclosure obligations. The tailored quality of disclosure obligations extends to both qualitative and quantitative disclosures. The result in large part has not been mindless form-over-substance requirements. Rather, the SEC's rules require dramatically different levels and types of disclosure depending on the size, nature and risks of an issuer's business activities.

Despite the fact that the SEC is and has been a classic example of the "regulatory monopolist," it has not generally acted in a monolithic or pressure-resistant fashion on disclosure. Instead, as shown in Part II-C, it has been responsive to the majority (if not all) of the concerns of corporate America, both in its procedures and in the substance of its rule-making. Nor has the SEC suffered from bureaucratic inertia, unwilling to modify proposals, when faced with critical comments, or even to engage in dramatic revisions to its most basic rules. As a result, the SEC remains a highly respected government agency, n38 even among political constituencies [*544] otherwise inclined to doubt the value or abilities of government regulators, and particularly among those constituencies who would (if devolution proponents are correct) most benefit from the abolition or reduction of its power over disclosure regulation. n39 At a minimum, these facts pose a puzzle of political economy for those in favor of devolution and regulatory competition: why has the SEC not acted to harm investors and issuers more than it has? Part II-D draws on economic theories of regulation to provide a preliminary answer to this question, an answer that needs to be considered in evaluating the relative merits of centralized versus devolved securities regulation.

A. Exemptions: Private Choice of Disclosure Obligations

The primary way issuers have choice over their disclosure obligations is by structuring capital raising efforts to comply with exemptions in the federal securities laws. From their inception, those laws did not attempt to regulate all issuers or all securities, and both the 1933 Act and the 1934 Act contain explicit exemptions permitting issuers to raise capital without triggering mandatory ongoing public disclosure. More importantly, the SEC has exercised its authority to broaden and create additional exemptions under both acts. Over time, the SEC has used these exemptions to develop the present disclosure regime, which provides issuers with a degree of choice over the extent and nature of regulation of both primary and secondary securities markets that is large and has increased over the past twenty years. Issuers can, and do, raise massive amounts of capital by issuing securities in private offerings, limited offerings, 144A offerings and registered offerings, with varying degrees of SEC oversight and prescriptive disclosure.

Pursuant to Sections 3 and 4 of the 1933 Act, the SEC has adopted Regulation D, n40 which exempts different types of securities [*545] offerings from some or all of the 1933 Act disclosure rules. For small issuers, Rule 505 permits issuers to raise up to \$ 5 million of capital from an unlimited number of accredited investors without triggering any affirmative disclosure requirement under the 1933 Act, and the 1934 Act likewise exempts such issuers from ongoing disclosure if they have less than \$ 10 million in assets or less than 500 equity holders (and do not list their securities). n41 More important, Rule 506 permits issuers to raise unlimited amounts of capital from sophisticated purchasers in blocks of \$ 150,000, plus up to thirty-five blocks of any size. n42 Thus, if sales are limited to large block sales to institutions, issuers are legally free to raise unlimited amounts of capital without complying with the disclosure requirements of the 1933 Act. If an issuer limits its total number of equity holders to less than 500 and does not list its securities on a public exchange, it will remain exempt from the disclosure requirements of the 1934 Act as well.

True, limitations on resale by purchasers in private placements will constrain the liquidity of securities sold by such issuers, but the adoption of Rule 144A has greatly facilitated the availability of secondary "institution-only" offerings of privately placed securities, which have rapidly expanded in the United States. n43 A recent study of the domestic 144A market finds that yield premiums on below-investment-grade ("junk") 144A bonds are "vanishing," and concludes: "Investors now regard ... [144A securities] as no less liquid than their public counterparts." n44 Although the study notes that most 144A securities are subsequently registered, enhancing [*546] their liquidity prospects, they are also "very

liquid to begin with." n45 Investment Dealers' Digest speculates that all high-yield debt will be issued in the 144A market in the not-too-distant future. n46

Together, these exemptions make full-blown registration and compliance with the disclosure rules of the 1933 and 1934 Acts mandatory only for issuers who wish to access retail equity markets in the United States. While the importance of that market remains significant, the ability to raise capital directly from institutions without registration has increasingly diminished the need to tap the retail equity markets over the past thirty years. As is well known, institutions now hold over 50% of securities in the public stock market and a much larger share of the bond market, and the long-term trend is toward greater institutional ownership of securities of all types. n47 As a result, leveraged buyout funds are, and have for twenty years been, able to raise billions of dollars for investment in portfolio companies, often to take those companies private, making them fully exempt from the disclosure rules. n48 Likewise, venture capital funds raise equally large amounts of money from institutions in private placements and then use that [*547] capital to fund the growth of start-up companies. n49 In both cases, the availability of the public equity markets as an "exit" provides an important way of liquidating portfolio investments when market conditions are ripe or fund termination dates approach. But the willingness and ability of both types of private equity funds to hold onto portfolio investments for long periods of time, and in some cases to transfer them to other private owners, n50 demonstrates the increasing breadth and liquidity of the private equity markets under existing rules.

An examination of transatlantic offerings over the past decade provides evidence of the diminishing cost advantage of tapping into public U.S. equity markets. n51 To the extent that private capital markets in the United States represent an attractive alternative to European issuers wishing to raise capital in the United States, the claim that issuers retain substantial choice over securities regulation even when selling to U.S. investors is that much stronger and the advantages for devolution that much weaker. n52 Over the past ten years, the amount of capital raised in the United States by European issuers has grown dramatically. Based on data from Thomson Financial Securities Data (TFSD), the number of transatlantic offerings (public and private) in the United States has jumped from about twenty in 1990 to over 100 in 1999 and more than 135 are projected for 2000 (based on the first six months' data). n53

Up through 1995, the rate of growth for public offerings outstripped the rate of growth for private offerings, which is not surprising, given the paucity of public offerings by European issuers even within Europe prior to the 1990s. However, since 1995, the number and rate of increase of private offerings (private placements [*548] and Rule 144A offerings) has outstripped the number and rate of increase of public offerings. In each of 1998, 1999 and 2000 (based on the first six months' data), the total number of private offerings was more than 33% higher than the number of public offerings in the United States by European issuers, despite the fact that the number of public offerings in each of those years remains above historic (pre-1990) levels. n54 Because public offerings are typically much larger than private offerings, it is not surprising that when one looks at the dollar volume of offerings, public capital-raising has been more important to European issuers. But even when measuring dollar volume, capital raised by European issuers in U.S. private placements exceeded capital raised in U.S. public offerings in 1998, and was nearly equivalent in 1997. Private placements have provided nearly 40% of the total capital raised in transatlantic offerings in the period of 1996-2000. n55

Data from the New York Stock Exchange (NYSE) and TSDC also shows that among new U.S. listings by European issuers, the importance of American Depositary Receipts (ADRs) - traditionally used as a vehicle for retail equity investment and generally viewed as an unattractive investment vehicle for institutional investors - has fallen. n56 For the institutional market, which can be reached with minimal disclosure through private placements, public offerings of ADRs by European issuers are a decreasingly important feature of the capital raising process. In 1996, the median percentage of shares offered in ADR form in the United States by European issuers made up about 85% of the total shares offered in the United States by those issuers, but by 1999, that number had fallen to 15%. n57 In 1995, the number of ADR shares at the end of the offering year was roughly equal to the number of ADR shares included in the primary offerings; in 1996-1998, the year-end ADR percentage averaged only about half of the ADR shares included in the primary offerings. n58 Both of these figures show that ADR listings are no longer important for providing liquidity for U.S. institutional holders, which dominate the initial public offering process in the United States. As a result, the importance of publicly registering shares in the United States is also less important for European issuers than it has been in the past.

[*549] This evidence demonstrates what is common knowledge among securities practitioners: private placements provide a significant and only modestly less attractive alternative route for large issuers seeking to raise substantial amounts of capital in the United States - a route that does not entail ongoing public disclosure obligations. n59 One investment banker states that "accessing U.S. public markets provides foreign issuers only 15% more potential buyers in the United States than does a Rule 144A offering." n60 European issuers are on track to raise almost \$ 20 billion in private placements in 2000 alone. The fact that many European companies take the extra step to register public offerings in

the United States (often to obtain a fully registered "acquisition currency" for mergers and acquisitions in the United States), despite the relative unimportance of public registration, suggests that whatever the cost imposed by the SEC's disclosure rules, that cost is not prohibitive for many issuers. Just as important for the principal points of this essay, it was the SEC, a regulatory monopolist, that opened up private capital markets by adopting Rule 144A, now increasingly being tapped by European and U.S. issuers. If simple public choice models of regulatory incentives are taken seriously (as they seem to be by advocates of devolution), one would have expected the SEC to do everything in its power to retain the greatest degree of regulatory control over the subjects of its empire so as to extract the greatest degree of private benefits from exercise of regulatory discretion. Yet the effect of the SEC's adoption of Rule 144A has been toward less control over disclosure in institutional markets, not more.

B. Tailoring

Even when companies embrace the public securities markets and incur the obligation to comply with the SEC's full-blown disclosure regime, the rules simply do not apply to them in a "onesize-fits-all" [*550] fashion. In addition to the exemptions noted above, SEC rules are substantially less burdensome for small public issuers than they are for much larger companies. Even first-time issuers are sorted into those required to use the full-blown registration on Form S-1, those that can use the "mini-registration" process on Form 1-A, and small business issuers eligible to use Forms SB-1 and SB-2. Offerings of up to \$ 5 million can be accomplished with even less disclosure under Regulation A. Under the 1934 Act, small business issuers may comply with the reduced disclosure requirements of Regulation S-B n61 rather than the more extensive requirements of Regulation S-K. n62 Given that the marginal effect of additional costs associated with mandatory disclosure would principally affect small issuers, the fact that the SEC has already substantially lessened that burden by tailoring its rules based on firm size again argues that the net benefits of devolution and regulatory competition are likely overstated.

Beyond this degree of formal tailoring, the SEC's specific disclosure requirements, as well as its general anti-fraud rules, permit a high degree of informal tailoring of disclosure documents to the issuer. The larger the company, the larger the exceptions for immateriality. For a company with \$ 10 billion in assets, a lawsuit with an ad damnum of \$ 10 million not involving allegations relevant to the competence or ethics of executive officers, and not suggestive of any trend or related future lawsuit, will trigger no disclosure requirement, either qualitative or financial. For a \$ 10 million company, that same lawsuit, if it has a realistic possibility of being decided adversely to the issuer, will trigger disclosure.

Throughout its rules, the SEC has, thus, explicitly or implicitly built in "materiality-based" tailoring, giving issuers a great deal of flexibility to choose a level of disclosure appropriate for the investment risks associated with their securities. Rule 260 under the 1933 Act contains a materiality threshold for deviations from the disclosure requirements of Regulation A. n63 The critical requirement of "risk factor" disclosure in offering prospectuses - and, indeed, whether even to include risk factor disclosure for mature companies - is open-ended: issuers have the ability to limit their risk-factor disclosure to risks that are relevant to investors, based on the judgment of the issuer and its counsel, subject to the minimal [*551] requirement that their choices be prima facie reasonable to an SEC examiner. Even the decision of whether an offering document will be examined by the SEC is tailored to the size, nature and likely risks posed by an offering. Currently, less than 15% of all offering documents are reviewed, with examiners focusing on initial public offerings and merger documents, and rarely if ever carefully reviewing typical offering documents of seasoned issuers. Of those that are reviewed, typical review periods are less than one work week for straight debt deals, which is often little more than the time necessary for issuer attorneys to draft, circulate and complete the documents necessary as a matter of contract law. n64

Under the 1934 Act, Rules 10b-5 n65 and 12b-2 n66 perform the same function for statements filed under sections 12, n67 13 n68 and 15(d). n69 Rule 12b-31 n70 permits the omission of duplicative or substantially equivalent exhibits. Companies exposed to environmental risks as a result of their operations report on environmental liabilities; those that are not exposed do not report such liabilities, and the SEC engages in little pre-offering or pre-filing ex ante regulatory "examination" to verify issuer decisions on those matters. Similar "materiality-based" tailoring is implicit or explicit through the U.S. GAAP.

As an admittedly crude measure of the degree to which disclosure requirements are tailored to company or offering size, I compared the length of the annual reports on Form 10-K of ten randomly chosen companies in the Fortune 500 with ten randomly chosen companies with assets under \$ 100 million that went public in 1998. This comparison revealed that the latter averaged 25% fewer pages than the former. A comparison of Form S-1 offering documents by ten companies listing stock on the NYSE in 1998, with ten other companies engaged in offerings registered on Form SB-1, revealed even more dramatic tailoring. The full filings, as well as the combined financial statements, notes to financial

statements, and management's discussion and analysis, averaged [*552] five times more pages in the former group. Likewise, a comparison of ten randomly chosen 1998 10-Ks and 10-KSBs showed that the former average about four times longer than the latter.

Disclosure requirements and accounting standards are also highly tailored by the industry of the issuer. Line items on financial statements, for example, are determined by the nature of the business, its products and customers. Financial companies report "net interest margins" and manufacturing companies report "cost of goods sold." Annual reports of ten bank holding companies randomly chosen from firms tracked by Compustat were 2.5 times longer than reports from ten randomly chosen non-financial companies. Based on my experience drafting disclosure documents for scores of mergers and public offerings, these differences understate the degree to which current rules permit tailoring of disclosures to the nature and type of business a firm conducts. n71

The degree of tailoring reflected in the SEC's current disclosure regime illustrates that it may impose a much lower burden than devolution advocates suggest. Since the rules governing public company disclosure already have a significant degree of flexibility and specificity built into them, the case for devolution - which depends in large part on the idea that regulatory competition will produce more tailored rules - becomes weaker. The fact that the SEC has developed a system over time with the degree of tailoring that it has seems hard to reconcile with the political picture of the SEC painted by devolution advocates. These advocates conventionally depict the SEC as a regulatory monopolist resistant to the interests of issuers and investors. However, such a monopolist would be unlikely to expend the effort to tailor disclosure rules to the degree the SEC has done, given that it would be cheaper and [*553] easier for the agency simply to adopt rules that truly were "one-size-fits-all."

C. The SEC's Responsiveness to Industry Concerns and its Role as Political "Circuit Breaker"

Over the past two decades, the SEC has undertaken a number of regulatory initiatives with the goals of reducing regulatory costs while maintaining or enhancing the quality of their regulations. In 1982 it adopted "integrated disclosure" and "incorporation by reference," greatly reducing the costs of duplicate disclosure that had been required by the 1933 and 1934 Acts, n72 and began permitting "shelf registrations," n73 bringing greater flexibility and speed to the 1933 Act registration and offering process. Since then, it has permitted even greater levels of pre-packaging of offering documents in the form of so-called "medium term note" programs, which provide issuers with maximum flexibility to pre-register a wide range of debt and hybrid debt/equity securities and postpone finalization of terms until offer and sale. n74 Rule 144A itself was a dramatic innovation. n75 Regulation M essentially exempted the great majority of trading during public offerings from traditional prohibitions against market manipulation on the ground that markets in most securities were sufficiently liquid that manipulation was difficult or impossible. n76 Most recently, the SEC has moved substantially to [*554] allow electronic disclosure of offering and other disclosure documents, and its rules are hardly being outpaced by technology. n77

In addition to undertaking major regulatory initiatives that benefited issuers and investors, the SEC has also frequently responded to industry criticism that the costs of proposed new rules would outweigh their advantages. n78 Its much-publicized "Aircraft Carrier" release, for example, which the SEC intended to "modernize and the regulatory structure for offerings under the [1933 Act] while maintaining investor protection," was killed essentially because Wall Street did not like the idea. n79 When the attempt of the Financial Accounting Standards Board (FASB) to require companies to run stock options through the income statement met with fierce criticism from option-dependent high-tech industries, the SEC did not object to the compromise of increased disclosure in the notes to financial statements. n80 Criticism of the SEC derivatives [*555] disclosure rules led it to revisit the rules. n81 Despite clear academic and policy sentiment in favor of abolishing pooling accounting treatment for mergers, n82 the SEC has tacitly permitted the FASB to postpone its abolition until after the next election, the outcome of which could result in greater political pressure on the FASB (and the SEC) to drop the proposal. n83 Moreover, the SEC dropped a 1979 proposal to require disclosure on accounting controls based on the additional costs involved. n84 The SEC has also supported industry-backed legislation, including the 1996 and 1998 Acts, even when they were opposed by politicians purporting to represent the interests of investors. n85

Most importantly for this article, the SEC has itself served as a sort of political "circuit breaker" during times of financial crisis. When the invention and sharp rise of hostile tender offers generated powerful congressional sentiment to effectively kill the tender offer mechanism for hostile bids, the SEC was able to intervene and shepherd through a greatly softened Williams Act that preserved [*556] that part of the market for corporate control. n86 Interestingly, state laws passed in the late 1960s and early 1970s were more restrictive than the federal statute, and it is far from clear that the hostile tender offer would have survived had it not been for the passage of the federal statute, combined with judicial

intervention striking down the most restrictive statutes on preemption and dormant Commerce Clause grounds. n87 During the long bear market of the late 1960s and early 1970s, the SEC was able to interpose itself between activist members of Congress who wanted to create a securities brokerage equivalent of the Federal Deposit Insurance Corporation (FDIC), with its associated regulatory baggage. The result was an industry-sponsored bill creating the Securities Investor Protection Corporation (SIPC), which would impose a relatively light burden on the securities markets. n88 When the market crashes of 1987 and 1989 generated first a public and then a congressional search for someone or something to blame, the SEC played an important role in defusing a politically risky situation for the investment community. As this article was being prepared, SEC officials were testifying before the House Finance Subcommittee at a hearing on organized crime on Wall Street, countering claims by officials from the Federal Bureau of Investigation (FBI) that organized crime has had a "significant" involvement in the securities markets in the 1990s, and dampening congressional enthusiasm for legislative changes. n89

[*557] Over and over again, the SEC has functioned not only to regulate, but also to keep in check political tendencies to legislate. The system of federal regulation currently in place has endured many apparent crises and, given its relative prominence as one of the principal regulatory constraints on the flow of capital, has remained remarkably durable. The durability and ability of the current system to overcome crisis is due, in large part, to the SEC itself.

Modest support for this reasoning can be found in the public comments of industry organizations on the SEC's June 2000 concept release on international securities harmonization. The Business Roundtable identifies political risk as its first issue about international accounting standard setting. n90 Specifically, its concern is that "the structure of the international accounting standard setting body ... ensures that the process is free of undue political pressures from any interest group and must remain accountable to the interests of investors." n91 At the international level, industry leaders have thus focused more on the political role that a securities disclosure regulator might play, than on disclosure standard-setting or other narrow functions conceived by devolution advocates as the most important roles played by the SEC.

The SEC's track record in protecting the interests of investors and the securities market is far from perfect. Its long resistance to forward-looking disclosure seems hard to justify. n92 It has sometimes stumbled when trying to balance the interests of small and unsophisticated investors with the interests of investors as a whole. Additionally, its most recent effort to compel "equal access" to information through the adoption of Regulation FD may turn out to be a mistake. n93 The right comparison is not perfection, however, but the politically and practically realistic alternatives. Even the strongest advocates of devolution grant that Delaware corporate [*558] law, produced by devolution in that sphere, is not without its imperfections. n94

D. The Role of Congress and International Competition

Readers may object at this point by saying that the SEC would not have been so responsive to issuer concerns over the past two decades had it not been for pressures from elected officials, especially Congress, and from international competitive threats, particularly the European securities markets. This is no doubt true. Congress, by using its ability to call hearings and put a spotlight on the SEC's actions, has been successful in pressuring the SEC to change its direction on several occasions n95 and, more importantly, has served as an important check on the inevitable empire-building tendencies of unelected bureaucrats. n96 Rule 144A was adopted, in large part, because of concerns that U.S. issuers were going abroad to raise capital in institutional markets. The import of such objections, however, is not clear. The fact that the SEC is already subject to important constraints in setting disclosure standards should, if anything, undermine the case for devolution. The role of Congress in pressuring the SEC and the need of the SEC to respond to international competition, even under the existing issuer-based regime, illustrates how the existing political equilibrium has produced private choice of securities disclosure regulation.

To sum up the argument thus far in Part II, the existing federal disclosure system provides issuers with substantial choice, is significantly tailored, and is the result of a responsive SEC willing to undertake fairly dramatic deregulatory steps, sometimes on its own initiative, sometimes at the behest of elected officials acting on behalf of industry interests, and sometimes due to existing [*559] competitive threats. At a minimum, what this brief review of existing private choice, tailoring, and responsiveness shows is that even if federal regulation is "sheltered from competitive pressures," n97 in the sense that issuers do not directly choose their overall regulator when selling securities in the United States, regulators are far from sheltered from political pressures under the current regime, nor are they fully sheltered from competitive pressures generally. As Mahoney puts it, "we should not ... expect a governmental regulator to be substantially more resistant to pressure from exchange members than is the exchange itself." n98 This point also holds true for pressure from issuers. Governmental regulation - at least in this case - has not acted to "freeze" rules into place. n99

As Fox notes, more than asserting that the SEC is a regulatory monopolist or that the current regime represents a "governmental failure" is needed to make a convincing case for devolving securities regulation. n100 Devolution advocates also need to reconcile such assertions with the fact that the SEC has been as responsive to industry interests as it has. The SEC has often acted to reduce its regulatory domain, sometimes radically so (as with Rule 144A), to expend regulatory resources searching for ways to reduce the burden it imposes on issuers, and to abandon proposals that met with industry criticism. Two of the reasons it has done so have already been noted: pressure from Congress and international competition. Before turning to the political risks that devolution might present, it is worth spending a moment considering other reasons, drawn from economic theories of regulation, that the SEC might have acted as favorably to industry as it has.

E. Models of Regulation

Models of regulation and regulators fall into distinct types, including public interest, public choice and capture models. n101 All [*560] have been made more complex in the last twenty years to reconcile them with the wave of federal deregulation that began under President Carter and continued under President Reagan. "Public interest" models assume voters prefer regulation if and only if it is efficient, and that politics will follow voter preferences and predict regulation where markets fail, with there being deregulation if changes in markets eliminate market failures and re-regulation only if new market failures emerge. n102 "Public choice" models assume regulators create and design regulation so as to retain economic rents for their own personal gain and predict deregulation where it would provide an even greater side-payment for regulators, or where voters are able (often for unspecified reasons) to impose constitutional changes constraining regulation. n103 "Capture" models (or as they are sometimes called, "economic" models) assume voters pursue regulation for rent-seeking purposes, that politics is a function of voter preferences and organization costs (i.e., collective action problems), which confront different potential coalitions of voters, and that regulators are, by and large, unable to retain more than a minor amount of rents for themselves. n104 Capture models predict regulation where exogenous differences in organization costs make it possible for one group of voters (according to Stigler, producers) to "capture" some degree of regulatory power and extract rents for itself from another group (according to Stigler, consumers). n105 Deregulation occurs either because available rents dissipate, or because of exogenous shocks to prior patterns of organization costs.

[*561] The academic discussion of disclosure devolution is being debated using almost exclusively public interest models, with an implicit if poorly specified public choice model lurking in the background. The implicit assumption of advocates and critics alike is that if the case can be made that social welfare would be increased (or decreased) by devolution, devolution should (or should not) follow as a matter of course. To the extent devolution advocates assume the existence of a poorly motivated regulatory agency unwilling to perform its job of developing disclosure rules in an efficient fashion without the threat of regulatory competition, they seem to have some sort of public choice model in mind. Both welfare and public choice analysis clearly contribute to an understanding of regulatory behavior. However, the competing capture model of regulatory behavior may do a better job of predicting the actual outcome of the debate by bringing some politics into the picture. Since policy choices must be made in a second-best world, constrained by existing political institutions, a capture model may also improve the welfare debate itself.

A capture model, for example, offers theoretical reasons why the SEC would not have acted solely in the self-interested ways suggested by public choice models but rather by "happy accident" in the public-regarding manner suggested by public interest models. The SEC is subject to several forms of control by elected officials: commissioners are appointed by the President, confirmed by the Senate, and operate with a budget set by negotiation with both the President and Congress. To pass that political muster, appointees are screened to respond to the political preferences of voters. The SEC often seeks new legislation from Congress, the majority party of which cannot be expected to oblige if the SEC has strayed too far from the ideological goals of a majority of voters.

Notwithstanding these political controls, however, at least during periods of "normal" politics when securities-related issues are not on the "public agenda," n106 the SEC will have little reason to worry about the policy preferences of voters as a whole. Despite the pronounced rise in stock ownership among individuals in the United States, most voters do not concern themselves with the ordinary activities of the SEC. In fact, voters would face large collective action problems were they to want the SEC to take a particular action. Agents of large, high-growth or capital-intensive [*562] corporations, large investors, investment banks, venture capital funds, Wall Street law firms, and organizations representing those groups, face relatively lower organization costs than dispersed voters, and can be expected to exert a much greater influence on the SEC than do other members of the polity.

Even if voters were to organize around an issue of importance to the SEC, independent agencies, such as the SEC, are more able to resist general political pressures to alter policies in ways that would harm their regulatory constituents. For example, assume that in the past a majority of voters were either indifferent to or supported an SEC policy P1, but that as a result of some exogenous shock (e.g., a market crash), were sufficiently unhappy with P1 that they would be willing to incur the costs necessary to elect political representatives favoring a radical new policy P2 not favored by current political representatives. It would take on average one year to obtain working control of the House with new representatives favoring P2, since the delay before the next federal election would range from zero to two years. For the presidency, the average delay for control by the new majority of voters would be two years, and for the Senate, three years, because it would take two election cycles. Thus, to obtain working control of the federal executive and legislature, the delay would be three years, on average, and only at that point could the new majority count on being able to appoint new SEC commissioners favoring policy P2. Since the SEC has five members, with one appointed each year, it would take an additional three years before control of the SEC could be reliably obtained, and the new policy implemented. The structure of control over the SEC insures that any voter coalition in favor of P2 would have to hold together for six years, double the time required to implement the policy through legislation. n107 An independent agency like the SEC imposes delay (and thus, all else [*563] equal, stability) on the law-making process at the federal level, and reduces the power of voter coalitions to affect its policies. Industry interest groups able to directly affect the SEC's policies are to that extent further empowered.

It should hardly be a surprise, then, that many SEC commissioners and chairmen have been drawn from business or Wall Street - such as its highly successful first chairman, Joseph Kennedy, a notoriously successful businessman; William Casey, a venture capitalist; Harold Williams, a businessman and dean of the UCLA business school; or the current chairman, Arthur Levitt, the former president of Shearson Hayden Stone, Inc. - and that SEC staff members frequently find post-SEC employment with Wall Street firms or large corporations. n108 SEC literature used to recruit law students contains ringing endorsements from former SEC staffers who now include the Vice Chairman of Merrill Lynch, as well as partners at major law firms, and in the 2000 brochure, modestly notes that, "former SEC staff attorneys have moved on to careers at the highest levels of securities firms, self-regulatory organizations, corporations, other government agencies and law firms." n109 It should also be no surprise, then, that the SEC has been as responsive as it has in expanding private choice of disclosure rules, tailoring its rules to issuers, and responding to industry concerns. To be clear, this analysis should not be read to suggest that the SEC favors industry interests over the public interest. [*564] It may well be that the externalities of securities regulation are sufficiently small that what is good for capital-raising firms is good for America. However, nothing about devolution would reduce any externalities associated with disclosure regulation. n110

With the capture model in mind, consider what effect devolution might have on disclosure rules changing to suit industry preferences. To the degree that devolution would produce regulatory competition, n111 it would, as devolution advocates claim, probably decrease any ability of regulators to retain rents for themselves. But, if the existing political economy of securities regulation is as just sketched, then the SEC and its staff are unlikely to be retaining large amounts of rents for themselves as it is. To the extent rents exist, they may consist largely of protection against political change that would satisfy transient social preferences, and reduce long-run social welfare, as is arguably the case with monetary policy and the Federal Reserve Board. Introducing a competitive element into the regulatory picture might create some marginal improvement in regulatory incentives. However, if devolution were to produce a fragmented regulatory structure, one might also [*565] worry that the political pressure that industry could bring to bear on any given regulator might diminish. Lobbying efforts would be divided and the total number of regulators would increase. While the efforts of other political forces, such as unions, environmental organizations, and consumer lobbies, would also be fragmented, the outcome of any given political struggle over some new disclosure issue might well be different than under the status quo. Issuers might be averse to this type of political risk. n112 For investors or issuers, there is no reason to think that the political economy of devolution would be better, and some reason to think it might be worse, than the current regulatory structure.

III. Public Choice of Securities Regulation Under Devolution

In addition to the political risks associated with multiple regulators, devolution creates another risk: re-regulation. n113 Without an analysis of the forces that produced federal securities regulation to begin with, and some explanation of what has changed to make those forces less strong today than they were seventy years ago, arguments for devolution fall short. Even if one can build a plausible case that devolution would produce short-run welfare gains, those gains will be illusory if devolution is not politically stable. In this Part, I offer three reasons why devolution would not be politically stable: (1) the likelihood that political entrepreneurs will propose to re-regulate securities at the federal level, given

the high probability of future recession, financial panic or high-profile financial scandals; (2) background populist suspicion of secret wealth and power, particularly as concentrated on Wall Street; and (3) the fact that the gains promised by devolution are almost intrinsically uncertain, which has political implications. In addition, re-regulation would be made more likely by the reduction in power of the SEC that devolution would entail. Finally, the political effect of reducing the power of the SEC is also a reason why [*566] the political risks posed by re-regulation, should it occur, are greater than simply restoration of the regulatory status quo. To that, I add two additional reasons why re-regulation would be politically risky: (1) the circumstances under which re-regulation would occur; and (2) the increased scope for regulation that would be created if devolution were to "wipe the slate clean" at the federal level.

A. Why Federal Securities Regulation?

Devolution advocates have attacked federal securities regulation for failing to maximize the public interest, arguing that the market failures it was supposed to address were either unreal or exaggerated and, in any event, less than the costs of the regulatory monopoly it created. What they have not done is explain why statutes mandating disclosure were enacted in the first place, or why they have been tolerated for seventy years, if they were not designed to remedy, and do not serve the public interest by remedying, market failures. Mahoney argues that a limited amount of backward-looking mandatory disclosure serves the public interest by remedying one particular type of market failure: agency problems between managers and investors. n114 But even he acknowledges that the only way to explain the current regulatory regime - which requires much more extensive disclosure, some of which is forward-looking - is to posit that the disclosure rules were hijacked along the way, presumably by both the SEC and, by virtue of its inaction, Congress, for reasons that remain mysterious, in spite of the harm that shift allegedly inflicted on issuers. n115 What political forces could drive the SEC and Congress to abandon the public interest and over-regulate disclosure, and why did the public not resist? I offer the following concededly speculative account of why federal regulation of disclosure was a likely political outcome in 1933 and why it would again be a likely political outcome if devolution were achieved in the near future.

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B. The Odds of (Re-)Regulation

As is well known, both the economy and the financial markets are subject to cycles. n116 In the short and middle term, what goes up must come down, even if, on average, both the economy and the stock market have a long-term upward trend. Sometimes, stock market downturns are slow and sustained, as during the late 1960s and early 1970s; sometimes, they are fast and sustained, as in the Depression; and sometimes, they are fast and short, as with the market break in 1989. Recessions have tended to be somewhat more regular, with down periods shorter than growth periods. n117 Nevertheless, recessions inflict serious economic and political dislocation when they occur. Financial scandals litter America history, from the 1905 Armstrong investigation, which "methodically extracted admissions from insurance executives of ... bribery, and self-dealing," n118 to the 1938 conviction of Richard Whitney, former NYSE president, for embezzling \$ 27 million from clients, n119 to the convictions of Ivan Boesky and Michael Milken for securities fraud in the 1980s, with the subsequent bankruptcy of Drexel Burnham and collapse of the "junk bond" market. n120

Nothing in macroeconomics is uncontroversial, and a few commentators have of late questioned whether the business cycle has been eliminated - in other words, whether the U.S. economy will [*568] ever again go into recession in a relatively predictable fashion. n121 It is interesting to note that commentators raised the same question in the 1960s, during the last unusually long expansion. n122 Even without a regular economy-wide downturn, however, future financial crises are likely. Unless human nature has changed or information asymmetries have been completely eliminated, financial frauds and scandals, on both the small and large scale, will be a permanent feature of the securities landscape. n123 Thus, the odds of some sort of financial crisis, recession or scandalous event occurring in the not-too-distant future seem almost certain, and the odds that all three will occur together seem substantial.

When the finance sector moves into a sustained bear market or suffers from a sharp and confidence-impairing crash or break, federal elected officials have often felt pressure or seen an opportunity to propose new legislation to deal with whatever real or perceived problem caused the bear market or crash. Likewise, when financial fraud or scandal is uncovered by prosecutors or journalists, it attracts public attention, and politicians react by holding hearings and floating new bills. Recessions, most of all, bring in sweeping political change, as evidenced by the elections of Roosevelt in 1932, Reagan in 1980, and Clinton in 1992. n124 Nothing in the [*569] devolution proposals would change these tendencies of recessions, crashes or scandals to drive politics.

When crashes, scandals and recessions occur together, as they have in the past, the pressure (or opportunity) for politicians to act is most acute. Even if legislative responses are bad for the public, politicians can nevertheless benefit from enacting new laws to the extent that two things are true: (1) the problem is complicated and good information about the problem is so costly to obtain and process that most voters will not become sufficiently informed to evaluate the merits of the proposals; and (2) the legislative solution has a possibility of remedying the problem. In such a situation, legislative action can be more politically attractive than inaction, at least where any net cost that the legislation imposes will not be verifiable for a long period of time. Action allows politicians to show they can "do something" while inaction requires politicians to defend a status quo tainted in the voting public's mind by the salient fact of market downturn or scandal. To the extent competition or media scrutiny constrains political choice in these moments, it tends not to push for inaction over ill-considered action, but instead, for different forms of action that vie with one another.

The political risks of recessions, crashes and scandals suggest that, should devolution be enacted, the odds of re-regulation are high. The trigger event will be a financial crisis or large-scale financial scandal that can be plausibly blamed on devolution, or the lowered levels of disclosure that advocates hope devolution will permit. The political point, if you recall, is not whether in fact devolution will have caused the crisis or scandal, but whether it is a plausible partial cause, and whether the actual or principal cause(s) of the scandal or crisis is sufficiently complicated that voters will be unable to know for certain. The history of federal securities law suggests that the lack of disclosure will have a role in most financial scandals, as it is difficult to do something financially scandalous if everyone knows about it. Furthermore, it is likely that the lack of disclosure will also have contributed to most financial crises, if for no other reason than the fact that whatever frauds come to light as a result of a crash will have, to that extent, "caused" the crash.

As Seligman notes, "within ten weeks of the ... [1929] crash, six members of Congress introduced bills to regulate corporate financial [*570] statements, margin loans, or short sales of securities." n125 After the beginning of the longer slide from June 1930 to August 1931, "the flurry of bills introduced were not just the hastily drawn creations of relatively obscure junior members." n126 Rather, they were led by "Virginia's Carter Glass, ... [a] lifelong conservative, ... [who] generally opposed 'centralized' federal power ... but [whose] conservatism permitted one consistent exception ... the application of federal controls against the New York City 'money crowd.'" n127 Indeed, even from the perspective of corporations that bear the brunt of regulation, regulation may be attractive if it helps restore investor confidence, return credibility to the financial markets, and reduce the cost of capital. "By 1933, ... there was obvious need to restore buyers' confidence. Everyone in the securities industry knew ... that something must be done." n128 The circumstances surrounding the initial adoption of the current disclosure regime shows the way that recessions, crashes and scandals can make regulation politically irresistible.

Likewise, the political point is not whether recessions that coincide with financial crises are caused by those crises, but whether they plausibly contributed to them in some meaningful way and, thus, whether regulation of the perceived causes of the crises might restore the economy's health. The continued belief of many professional historians that the Crash of '29 contributed to the Depression will make any subsequent correlation between crisis and recession plausibly causal. n129 Using the present as a guide for the future, the political pressure of legislative response to market crashes will only increase. The spread of stock ownership to a much larger segment of the voter population than at any prior [*571] point in history - with aggregate household investments in financial instruments exceeding \$ 9 trillion n130 - means that a market crash will produce a sudden loss of wealth for the portion of the American public with the greatest political power, both in wealth and in votes. As Hu notes, "stocks have become more than the asset class of just the elite. Between 1989 and 1998, the percentage of families earning \$ 10,000 to \$ 24,999 ... that held stock nearly doubled ... [and] the proportion of all families that had direct or indirect stock holdings rose ... to 48.8%." n131

In the rush to respond to this hypothetical, but likely, future crisis, at least some politicians will attempt to turn events against a previously devolved securities regulatory scheme, and push for re-regulation of disclosure at the federal level. Try to imagine a scenario in which none of the 536 elected federal representatives - or any of a large number of would-be representatives - seek to attempt to blame devolution at least in part for the crisis, scandal, or recession, or to "do something" by re-regulating disclosure. Mahoney essentially argues that political pressure of this sort is in fact the explanation for the original federalization of mandatory ongoing disclosure in the 1934 Act:

[The reasons the exchanges] were subjected to government oversight ... [and lost their exclusive role in setting disclosure standards] center on a perception that the exchanges made little effort to stop their members and listed companies from defrauding investors... . In the wake of the stock market crash of 1929 ... congressional and public opinion drew a causal link from the behavior of exchange members to the Crash. n132

Mahoney argues, in other words, that Congress, knowingly or not, acted on the basis of a misperception when it passed the federal securities laws. None of the devolution advocates offer any reason [*572] to think that Congress would do any better were a similar political moment to arise in the future.

C. Suspicion of Secret Power

Making re-regulation even more likely is the fact that Americans distrust an unregulated Wall Street. Roe, in his justly famous book on the political origins of U.S. financial regulation, makes a good case that an important part of the explanation for those regulations is a general, latent popular distrust of concentrated economic or political power. n133 This distrust has been particularly acute when power has been viewed as "secret." Secret cabals of cigar-wielding bankers holding politicians by puppet strings are a staple of the American political subconscious. An important factor in the history of the securities laws, neglected by devolution advocates, is that disclosure ("sunlight," to use Brandeis's phrase) was viewed by many wealthy businessmen as the lesser of the political evils presented by the disaster of the Depression. After all, socialism was taken seriously as a policy alternative by large numbers (often approaching a majority) of Americans in the 1930s. During this period, a majority of those polled supported public ownership of utilities, and nearly as many people supported public ownership of banks as opposed it. n134 As late as 1942, the "Roper-Fortune poll found that 25% felt that "some form of socialism would be a good thing ... for the country as a whole." n135 Disclosure rules served to defuse the demand for direct regulation of industry on several levels. First, most directly, it allowed politicians to show that something was being done. Second, it was directed at moneyed interests and, hence, discharged some of the Depression Era resentment of, and hostility toward, concentrated wealth. [*573] Third, it forced large businesses and investment banks to reveal, not just to investors but to the public, details of their operations, reducing that portion of populist suspicion that is most aroused by secrecy.

Rigorous comparisons across time of the degree of popular distrust of Wall Street or large corporations are difficult, but there is no reason to suppose that this distrust has disappeared. One need only recall the last relatively short-lived American recession at the beginning of the 1990s to note the way that unions and politicians catered to workers by attacking executive compensation at public corporations. At that time, public confidence in business was at an all-time low, with 14% expressing a "great deal of confidence" in "major companies," and only 9% expressing that level of confidence in Wall Street. n136 The outcome of that political attack was not substantial - the \$ 1 million cap on compensation for tax deductibility, with loopholes for option and bonus compensation - but it is illustrative of the way popular distrust of wealth can combine with a business downturn to express itself in policy in times of crisis, even today. By 2000, after years of economic expansion, the number of those polled with that level of confidence in major companies or Wall Street had doubled, at 28% and 18%, respectively. n137 As wealth and income disparities continue to grow even wider than they are now, the level of resentment directed at business and the securities markets could be expected to be much higher in the next recession. If conditions are otherwise ripe, general attitudes on the part of many American voters can be harnessed by entrepreneurial politicians.

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D. Uncertainty about Merits

A third and final factor that would make re-regulation likely in the event of devolution is that at both the level of theory and at the level of evidence, it is unlikely that any strong consensus among policy analysts will be soon reached on the merits of devolution. That is, it will be unlikely that there will be agreement on whether securities regulation is better done: (1) at the federal level (as with most aspects of current securities law); (2) in a system of devolved and competitive regulation (as with current corporate law); (3) in a system of devolved but monopolistic regulation (as with most aspects of current tort regulation); or (4) in a purely private system (as with most aspects of current contract law). At the theoretical level, Romano acknowledges that "economic theory provides limited guidance concerning whether a monopolist will provide the optimal degree of product quality, variety or innovation." n138 Likewise, Mahoney notes the "difficulty of determining optimal rules" of disclosure. n139 Although Romano believes the evidence in favor of devolution is stronger than others do, she also acknowledges the evidence she adduces in favor of devolution "does not prove ... that state competition would be better" than the current regime, that the expected benefits are necessarily based on an "educated prediction," or that the most one can say about the available evidence is that it does not support "blind adherence to the status quo." n140

Two political results follow from deep uncertainty about the merits of disclosure regulation. First, uncertainty has made (and will make) many different political positions on the topic plausible. Even among academics, reasonable people can disagree without worrying that they will look foolish or suffer any reputational penalty in doing so. As experienced lawyers know, honest admission of uncertainty in public discourse can often backfire in circumstances when no proof, one way or another, is available on an issue. The very fact of uncertainty makes acknowledging the uncertainty reduce one's credibility to uninformed audiences precisely when it might seem reasonable to think the admission will enhance it. The result of uncertainty in the political arena is that politicians willing to overstate their case tend to dominate careful politicians, [*575] and strong claims tend to drive out honest speech. n141 In the end, this discourse is driven to the low information level of the largely uninformed median voter. In essence, when a given issue is truly uncertain, the ability of the voting public to monitor either Congress or regulators on that issue is impaired.

Uncertainty thus creates political "slack," providing politicians with greater freedom to do as they please. n142 Absent capture of regulators by private interests, regulation becomes more likely if politicians are personally inclined to regulate. To the degree that slack created by deep uncertainty is inevitable, some degree of re-regulation of an issue becomes, if not inevitable, at least likely, by that fact alone. How governmental authority regarding an uncertain issue is allocated becomes critical. Regulatory agencies, like the SEC, which are run and staffed by people with some expertise on the issue, and who are drawn from the industry, will tend to be less likely to regulate an uncertain issue. This results either by the fact that they are expert enough to know that they do not know whether it would be a good idea, or because they are captured by private interests that would rather not be regulated. Elected politicians, who derive their power directly from voters, are more likely to seize the opportunity to regulate the uncertain issue as a part of their election platform.

A second effect of uncertainty is to make extreme political responses more likely: i.e., massive disclosures in excess of the current disclosure system. Although uncertainty tends to produce inertia in individuals, in groups it can produce rapid change, n143 because individuals faced with uncertainty tend to imitate one another. n144 Uncertainty creates the risk of an "availability cascade" which, as Kuran and Sunstein describe it, "is a self-reinforcing process of collective belief formation by which an expressed perception triggers a chain reaction that gives the perception increasing plausibility through its rising availability in public discourse." n145 Rather than the political process producing some compromise outcome, reducing variance in the range of likely regulatory solutions, [*576] uncertainty can produce outcomes that depend on focal points and starting points, with greater possible variance. Political uncertainty of this sort is not diversifiable, as there are no alternatives at any given point in time from which to choose. Risk-averse industry representatives would do well to avoid such political risks.

E. The Risks of Re-Regulation

If re-regulation were to occur, what would it entail? One possibility is that it would simply return us to the status quo. Under conditions of uncertainty, it is often rational to rely on precedents to guide behavior; the natural precedent for regulation of disclosure at the federal level being the existing system. If reinstatement of the status quo did result, devolution would have produced two sets of transition costs, including rent-seeking losses associated with both devolution and re-regulation. Those costs would be calculated against whatever net cost or benefit that devolution would have provided in the federal regulatory interregnum. Depending on one's assessment of the size of those transition costs, n146 the prospect of status quo restoration might itself be enough to caution against expending resources to pursue a broad program of devolution.

Re-regulation, however, might not be so benign. Recall the circumstances under which re-regulation is most likely to occur, using the initial enactment of the federal securities statutes as a guide. One or more of three things are likely to be going on: economic recession, financial crisis or a flurry of media reports of fraud and scandal. Re-regulation of disclosure is likely to be a politically attractive remedy for those aspects of the financial crisis that result from investor risk-aversion and lack of confidence regarding agency costs or fraud. Re-regulation of disclosure is also likely to address some aspects of the financial scandals relating to fraud or deception. Because the nature and severity of perceived problems will extend much further, however, the full domain of possible re-regulatory schemes is not likely to end with simply the reimposition [*577] of a disclosure regime to cure fraud and restore investor confidence.

At a minimum, there is a political risk that other aspects of the relationship between investors and issuers, traditionally left to state corporate law, would be federalized. Commentators have often noted the odd division of labor between federal securities law and state corporate law. Federal regulation of proxies, tender offers, and insider trading are all arguably much more integral to the substantive relationships among investors, firms, directors, and managers that are at the heart of corporate law, than they are to the disclosure-oriented emphasis of the existing federal securities statutes.

On the other hand, cash tender offers, mergers and recapitalizations involve investment decisions as important as an initial decision to invest and present similar opportunities for fraud and deception. Because of the difficulties lawmakers have had in untangling the strands of corporate and securities law, it may be politically attractive to shift all authority over the relationship between issuers and investors to the federal level. Indeed, the federalization of corporate law has been a recurring political risk even under the existing system of federal securities laws, and the SEC has had its hand slapped on more than on occasion for using disclosure rules to displace rules of corporate law. n147 To date, however, calls for the federalization of corporate law have been resisted, largely because no matter how controversial the states' decisions within corporate law have been, the effects on the public have generally been relatively minor. In the event of re-regulation under the shadow of recession, financial crisis or notorious scandal - all of which the states would plausibly bear some blame in the court of poorly informed public opinion - their political ability to hold onto corporate law will be greatly diminished.

In fact, the very structure of devolution could contribute to the risk of re-regulation. It is another oddity of the American legal system that corporate law for U.S. public companies is largely set by five chancellors appointed by the governor of one of the smallest states in the nation. Even in the best of times, and regardless of the merits of the competitive regulatory system, this oddity suffers from at least the appearance of a "legitimacy" problem. Most American voters do not understand why Delaware sets the rules of corporate law, and myths spring up where simple explanations fail. [*578] Even now, Delaware's supremacy is bandied about as evidence of a capitalist conspiracy. If securities regulation were devolved, and if (as seems likely) one or two small states, possibly including Delaware, emerged as market leaders, this legitimacy problem would be worse. Securities regulation matters more than corporate law, and matters to more people, particularly in a financial crisis.

There are even more extreme, if not less likely, political risks associated with re-regulation. The moment for re-regulation may well occur not just during a financial crisis affecting investors and issuers, but also during a recession, affecting the polity more generally. Among policy prescriptions that either have been taken seriously in the United States or were actually enacted in other countries in periods of economic turmoil (or in anticipation of such periods) are: "substantive" social and economic regulation via corporate law (as with Germany's system of co-determination), nationalization of whole industries, imposition of wage/price controls, rapid currency depreciation, and hyperinflation. The fact that these risks are not even remotely likely in the current environment does not mean that circumstances cannot change - to think otherwise is to, indeed, suffer from a failure of imagination. n148 Put in abstract terms, the policy space from which re-regulatory policies would be chosen would be enlarged by a prior enactment and discrediting of devolution.

I readily concede that this parade of horrors - the federalization of corporate law, substantive regulation and socialism - remains speculative (albeit educated by history). Moreover, as one moves out the scale of economically disastrous political remedies, the odds of any particular political disaster radically diminishes. Still, on an expected basis, investors and issuers with even a moderate degree of risk-aversion can be expected to weigh unlikely but large downside risks in their political cost/benefit calculus on the merits of devolution.

[*579] F. The Political Role of the SEC

Finally, consider again the political role of an independent regulatory agency like the SEC, this time in the re-regulatory process. All else being equal, if, as present, the SEC were delegated the task of responding to the market downturn or financial scandal, the policy outcome would be, on average, more attractive to the industry than if Congress and the President dealt with it directly. This is due to the expertise, background and future employment expectations of the SEC and its staff, as well as the additional delay imposed on the ability of voter coalitions to seize control of an independent agency, as analyzed in Part II-E. This analysis is borne out by the examples of the SEC's role as "political circuit breaker" described in Part II-C. Put in theoretical terms, the SEC functions not only as a regulator, but also as part of a "structural mechanism" that helps address the potential for chaotic or unpredictable political change implicit in the Arrow "impossibility theorem." n149 Along with such structural mechanisms as bicameral legislatures, separation of powers and rules of procedure, n150 the existence of a strong political actor representing the interests of industry can help maintain the status quo, rather than "freezing" into place inefficient disclosure obligations, as devolution advocates contend, but against harmful legislative initiatives that may be all too tempting to elected politicians.

Whether one believes that the net effect is an instance of "pure capture" or "Burkean independence" n151 is irrelevant in evaluating the relative attractiveness to industry of having Congress or the [*580] SEC be the primary political actor in such moments of crisis. That is, the merits of the competing legislative or regulatory responses, measured against some social welfare function, are not important in trying to understand the positive reality of politics. Moreover,

to the extent one believes, as devolution advocates appear to believe, that corporations have reasonably good incentives to contract for the appropriate level of disclosure to maximize not only their own private but also their social welfare, at least in the pre-investment stage, they should also believe that the behavior of a pro-industry SEC will be reasonably good for social welfare, when compared to the behavior of a more unpredictable Congress.

For this reason, devolution poses additional political risks for the industry beyond those arising from devolution itself or re-regulation on its own. Devolution as proposed to date will involve greatly reducing, if not eliminating, the SEC's role in establishing mandatory disclosure regulation. If a crisis or scandal were to erupt after devolution, the SEC would no longer be the only regulatory body to take on the job of investigating, analyzing, and proposing remedies. If the task of regulation disclosure were wrestled away from the SEC and given to the states or the stock exchanges, the SEC will have suffered a major political loss. Even if Congress could still plausibly delegate the task of responding to a financial crisis to the SEC, the SEC would no longer have the same level of authority and expertise as it does today, and the SEC's proposed solution would be less likely to win the day. Basic economic analysis of organization costs suggests that the total political power of the states and exchanges to fulfill the same pro-industry role as at present will also be reduced; that is, the greater the number of people necessary to coordinate for political action, the lower the odds it will be worth the cost for a fixed political benefit. Once the likelihood of future political activity is taken into account, devolution's main advantage - that it removes authority and power from a centralized political actor capable, in theory, of harming investor and industry interests - is also one of its main disadvantages.

Conclusion

In this article, I have argued that the SEC already offers a great deal of private choice of securities regulation, already tailors its rules to relevant features of investments, and is already a regulator highly responsive to industry concerns. In the language of economic theories of regulation, it bears all the marks of an agency [*581] that has been captured by industry interests. Whether this is for public good or ill is a topic for another day, but certainly for corporate America, altering the regulatory status quo promises political benefits that are smaller than has been appreciated. The failure of industry trade groups to pick up the devolutionary banner is thus not terribly surprising, even on that ground alone.

I have also argued that the potential costs of devolution are larger than previously recognized. The intrinsic uncertainty of the merits of devolution, the latent and dangerous populist resentment of secret concentrations of wealth, and the almost inevitable moment in the future when the economy is on its back, the stock market has stumbled, or some high-ranking securities industry executive is caught with hand in the till, makes the re-regulation of disclosure at the federal level more than likely. If re-regulation were to occur during a financial crisis, in the absence of a captured federal regulatory agency to participate on behalf of the industry in the political scramble, its outcome might well be not simply restoration of the status quo but something worse, from industry's perspective. Not only are the political benefits of devolution smaller than previously recognized, but the political risks larger.

This two-sided political explanation as to why devolution may not be a good idea has different implications than conventional critiques. For public-spirited policy analysts inclined to support devolution, more thought needs to go into how devolution will be protected from re-regulation in times of financial crisis, how to address the general popular suspicion of concentrated wealth and power in the private sphere, and how the high political costs of politically "hardening" any devolution of securities regulation might be reduced through new forms of feasible collective action. The analysis also suggests the need, more generally, for a dynamic theory of devolution in a political system that imposes high political costs on making effective commitments about long-term changes in regulatory structure, making re-federalization an ongoing risk for all types of regulation.

A possible, if not speculative, response to the concerns that the political risks of devolution raise is to try to achieve the benefits of regulatory competition without incurring all of the costs, by retaining federal regulation of securities but establishing some form of competition among federal regulators, as currently exists in part in the sphere of banking regulation. One might imagine two or three SEC-equivalents, one with authority over the NASDAQ, one with authority over the NYSE, and one with authority over [*582] other exchanges. Such a proposal has much in common with Mahoney's devolution proposal, but would resolve the enforcement issues and partly address the conflicts issues of exchange-based regulation pointed out by Kahan. Such a regulatory competition at the federal level would not preserve a single, powerful political actor to represent industry interests, but would fragment industry's political representation to a lesser degree than devolution to the states. Alternatively, and posing much lower short-run political costs, Cox's proposal to retain federal regulation of securities, but shift to a "duopoly" by allowing issuers to comply with international accounting standards, seems like a sensible way of introducing some of the potential economic benefits of devolution without risking its political downside.

Finally, the analysis suggests that trends toward increased "harmonization" may be desirable for reasons having nothing to do with the benefits customarily ascribed to it (at least in public): scale economies and benefits of standardization. Instead, harmonization may be attractive because, as is also true in the case of banking regulation, it will generate a respected, politically effective securities regulatory body that is expert, captured, or both, and may serve to protect industry interests by playing the same political roles in the international arena that the SEC plays domestically. Put otherwise, as globalization of the securities markets progresses, domestic issuers and securities professionals may need to consider not only what the most theoretically efficient system of disclosure regulation will be, but also whether and how their interests are to be represented in international politics. Industry support for international harmonization may also be explained more by politics than by economics (narrowly defined): to the extent that the SEC currently functions for industry interests, in effect, as an umbrella trade group, in part because it is cloaked with the authority and apparent neutrality of a government agency, the domestic interests of capital providers may also benefit from being represented internationally by their own governmental agent. n152

Legal Topics:

For related research and practice materials, see the following legal topics:

International Law Authority to Regulate Securities Pensions & Benefits Law Governmental Employees General Overview Securities Law Investment Advisers Exemptions, Recordkeeping & Registration

FOOTNOTES:

n1. See Stephen J. Choi & Andrew T. Guzman, Portable Reciprocity: Rethinking the International Reach of Securities Regulation, *71 S. Cal. L. Rev.* 903 (1998); Paul G. Mahoney, The Exchange as Regulator, *83 Va. L. Rev.* 1453 (1997); Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, *107 Yale L.J.* 2359 (1998).

n2. Throughout this article, I use the term "devolution" rather than "privatization" because the proposals set forth in the articles cited in note 1 above would retain governmental supervision over securities disclosure but would have the effect of making governments more responsive to issuers, thus devolving power, if not authority. Romano's proposal would also devolve regulatory authority to the states, and Mahoney's proposal would devolve regulatory authority to the exchanges, although private organizations would continue to have some ongoing governmental supervision. Choi and Guzman's proposal technically does not involve either devolution or privatization, but would have (in my view) the effect of devolving regulatory authority to specialized country-regulators, such as those in Bermuda, Luxembourg and the Caymans.

n3. See James D. Cox, Regulatory Duopoly in U.S. Securities Markets, *99 Colum. L. Rev.* 1200 (1999); Merritt B. Fox, Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment, *85 Va. L. Rev.* 1335 (1999); Marcel Kahan, Some Problems with Stock Exchange-Based Securities Regulation, *83 Va. L. Rev.* 1509 (1997); Howell Jackson & Eric Pan, Regulatory Competition in International Securities Markets: Evidence from Europe in 1999 (Sept. 18, 2000) (unpublished manuscript, on file with author); Hal Scott, Internationalization of Public Securities Markets, *63 Problems J.L. & Contemp. Probs.* 71 (2000).

n4. In addition to the colloquium for which this essay was produced, the devolution proposals have generated symposia at Duke Law School and the American Enterprise Institute. See, e.g., American Enterprise Institute Conference Summaries, A Market Approach to Securities Regulation (visited Sept. 18, 2000) <<http://www.aei.org/cs/9738.html>>.

n5. Throughout this article, I use "corporate America" and "industry" to refer to the interests of entrepreneurs, private equity funds and other owners of corporations who are likely to raise capital in the future, and who would thus benefit if the cost of equity capital were lowered. I thus assume (as do devolution proponents) that the securities markets are capable of pricing differences in disclosure regimes and disclosure standards. To the extent this is not true, the case for devolution is dramatically weakened. The terms also include trade organizations representing the interests of these individuals. It should be acknowledged that "industry" and its interests

are not homogenous, and "industry" agents may have their own political and economic agendas. See *infra* note 7 and text accompanying note 16.

n6. See *infra* notes 17-22.

n7. See, e.g., Susan M. Phillips & J. Richard Zecher, *The SEC and the Public Interest* 22-23 (1981) (claiming that SEC's disclosure policies favor market professionals); David D. Haddock & Jonathan R. Macey, *Regulation on Demand: A Private Interest Model, With an Application to Insider Trading Regulation*, 30 *J.L. & Econ.* 311 (1987) (claiming that the SEC's insider trading policies favor market professionals).

n8. See *infra* text accompanying note 16.

n9. Cf. Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 *Colum. Bus. L. Rev.* 1 (1999) (arguing that the trend toward greater private choice of disclosure regulation for primary offerings of securities permitted under federal securities laws suggests that more choice should be permitted, but only in that context).

n10. See Romano, *supra* note 1, at 2372.

n11. Devolution might be accompanied by political "hardening" of some sort - that is, laws, institutions or constitutional requirements would make subsequent changes to how disclosure is regulated more difficult, such as, at the extreme, embedding devolution in the Constitution. Such hardening would reduce the political risks discussed in Part III, but would, of course, raise the political cost of obtaining devolution initially.

n12. Throughout this article, "re-regulation" should be understood to mean "re-federalization of securities regulation."

n13. The analysis also suggests the need, more generally, for a dynamic theory of devolution in a political system that imposes high political costs on commitment devices for long-term changes in regulatory structure, making re-federalization an ongoing risk for all types of regulation.

n14. See, e.g., Bank for International Settlements: Committee on Banking Regulation and Supervisory Practices, *Consultative Paper on Proposals for International Convergence of Capital Measurements and Capital Standards*, 27 *I.L.M.* 524 (1988) (report of international coordinator of national bank regulators on capital standards). For a discussion, see Walter I. Conroy, *Risk-Based Capital Adequacy Guidelines: A Sound Regulatory Policy or a Symptom of Regulatory Inadequacy*, 63 *Fordham L. Rev.* 2395 (1995).

n15. See Choi & Guzman, *supra* note 1; Mahoney, *supra* note 1; Romano, *supra* note 1. To be clear, each would also allow the SEC to continue to adopt and enforce disclosure standards, which would be applicable to the extent issuers chose to comply with them. However, each devolution proponent envisions that a substantial number of issuers would choose not to comply with the SEC's rules.

n16. In theory, large corporations, represented by the Business Roundtable, might want to moderate competition by maintaining high capital costs for start-up firms, and by imposing a set of disclosure requirements on all companies regardless of size. Trade groups for small firms and the venture capital industry, however, appear equally uninterested in devolution. The SEC has taken steps to reduce the disclosure burden on small business, making this particular rent-protection story implausible as a political explanation of industry support for the current regime. See *infra* text accompanying notes 29 & 39.

n17. Pub. L. No. 104-290, 102 (codified as amended at *15 U.S.C.A. 77r* (West 2000)). Carney correctly notes the 1996 Act can be seen as a preference for harmonization, rather than for federal regulation per se. See William J. Carney, *Jurisdictional Choice in Securities Regulation*, *41 Va. J. Int'l L.* 721 (2001). It should also be noted, however, that the same political capital spent achieving harmonization through federal preemption of state regulation could have been spent achieving harmonization through one or another of the devolutionary schemes.

n18. Pub. L. No. 105-353, 112 Stat. 3227 (1998).

n19. Romano, *supra* note 1, at 2361.

n20. The 1996 and 1998 Acts were both supported by (among others) the American Electronics Association, the Software Publishers Association, the Information Technology Association of America (ITAA) and the National Venture Capital Association, trade groups and lobbying organizations representing the interests of high-tech start-up and growth firms from those industries. See *The Securities Litigation Uniform Standards Act of 1997: Hearing on S. 1260 Before the Subcomm. on Securities of the Senate Comm. on Banking, Hous., and Urban Affairs, 105th Cong.* (1997); *Securities Litigation Abuses: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Hous., and Urban Affairs, 105th Cong.* (1997); *The Securities Investment Promotion Act of 1996: Hearing on S. 1815 Before the Senate Comm. on Banking, Hous., and Urban Affairs, 104th Cong.* (1996); Tom Abate & Jon Schwartz, *11th Hour Victory for Tech*, *S.F. Chron.*, Oct. 16, 1998, at B1 (1998 Act, backed by "tech leaders" and "spearheaded" by ITAA, "capped a remarkable, come-from-behind legislative windfall for Silicon Valley").

n21. The Business Roundtable, *BRT Response to SEC Concept Release on International Accounting Standards*, (visited Apr. 27, 2001) available at <<http://www.brtable.org/document.cfm/435>>.

n22. Financial Executives Institute, *Comments on S7-04-00 (Ameen)*, (visited Apr. 27, 2001) available at <<http://www.sec.gov/rules/concept/s70400/ameen1.htm>>.

n23. See *The Market for Regulation*, *Economist*, Mar. 7, 1998, at 82 (discussing Romano proposal). See also *supra* notes 3 & 4 (academic responses to devolution proposals).

n24. See George J. Stigler, *Public Regulation of Securities Markets*, 37 *J. Bus.* 117 (1964); cf. Irwin Friend & Edward S. Herman, *The S.E.C. Through a Glass Darkly*, 37 *J. Bus.* 382 (1964) (critiquing Stigler).

n25. See Homer Kripke, *The S.E.C. and Corporate Disclosure: Regulation in Search of a Purpose* (1979); George J. Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 *Am. Econ. Rev.* 132 (1973); cf. Irwin Friend & Randolph Westerfield, *Required Disclosure and the Stock Market: Comment*, 65 *Am. Econ. Rev.* 467 (1975) (critiquing Benston).

n26. Romano, *supra* note 1, at 2363. Romano argues that issuers have resisted devolution because "they have not recognized the possibility of removing the source of the state-level problems of plaintiff forum shopping and burdensome registration requirements ... by altering the state jurisdictional rule of investor domicile to ... one state, chosen by the issuer." *Id.* at 2364 n.11. The possibility of displacing one state law with another by federal statute is not a novel one, however; federal banking law, for example, has for over a century preempted state usury laws in this way. See *National Banking Act*, 12 *U.S.C.S.* 85 (2000); *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 *U.S.* 299, 301 (1978) (applying the National Banking Act); Stephen G. Stroup, *Comment*, *Smiley v. Citibank (South Dakota), N.A.: Charging Toward Deregulation in the Credit Card Industry*, 22 *Del. J. Corp. L.* 601 (1997) (National Bank Act permits national banks to charge interest permitted under laws of bank's home state, regardless of borrower's state's usury laws). See also 28 *U.S.C.S.* 1738B(h) (2000) (federal statute overriding state choice of law rules regarding enforcement of child support orders in state

court); 28 *U.S.C.S. 1346(b)* (2000) (states that the Federal Tort Claims Act specifies choice of law rules for tort actions brought in state court). Likewise, the fact that Congress adopted express provisions repudiating any sweeping preemptive effect for the original securities statutes (and recently modified those provisions in the 1996 Act) demonstrates that the degree of devolution or centralization has been a political choice variable for as long as there has been federal securities regulation.

n27. See Anthony Downs, *An Economic Theory of Democracy* (1957); Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (1965).

n28. Pub. L. No. 104-67, 109 Stat. 737 (codified at *15 U.S.C.A. 77* (West 2000)).

n29. Pub. L. No. 96-477, 94 Stat. 2275 (1980). For SEC rules reflecting the Act, see Exchange Act Release No. 6949, 51 S.E.C. Dock. 2396 (July 30, 1992). For the role of venture capitalists and the SEC in connection with the Act, see H.R. Rep. No. 96-1341, at 19-20 (1980) (accompanying final bill, mentioning venture capital industry participants); H.R. Rep. No. 96-85, at 124 (1979) (testimony of National Association of Small Business Investment and National Venture Capital Association). This statute was stimulated by a report from the Advisory Committee on Corporate Disclosure, created by the SEC. As a member of that committee, Homer Kripke argued that mandatory disclosure was unnecessary given efficient securities markets - an essential hypothesis of the devolution proposals. For the statute's role in prompting the SEC to adopt Regulation D, see Revisions of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6389, 24 S.E.C. Dock. 1166 (Mar. 8, 1982). Regulation D is discussed in the text accompanying note 40, *infra*.

n30. Retirement Funds Want Bright Line Rule on Auditor Independence, *SEC Today*, Oct. 6, 2000.

n31. See U.S. Chamber of Commerce, U.S. Chamber Calls SEC Proposal Unwarranted <<http://www.uschamber.org/Press+Room/2000+Releases/August+2000/00-122.htm>> (lobbying against effort to split accounting firms' consulting and auditing businesses); U.S. Chamber of Commerce, Institute for Legal Reform, available at <<http://www.uschamber.org/Instituteor+Legal+Reform/About+Us/In+Congress.htm>> (lobbying for bill to move all class action litigation into federal court and out of state court).

n32. See The Business Roundtable, Corporate Governance, (visited Apr. 27, 2001) available at <<http://www.brtable.org/issue.cfm/2/yes/0>>. See also The Business Roundtable, Corporate Governance, "SEC's Proposed Rule on Supplementary Financial information," (visited Apr. 27, 2001) available at <<http://www.brtable.org/document.cfm/422>> (lobbying against SEC proposal to require, among other things, disclosure of "loss accruals from pending litigation").

n33. See Financial Executive Institute, Technical and Policy Issues, available at <<http://www.fe.org/tech/airCraftCarrier.html>> (lobbying SEC against "Aircraft Carrier release"); Financial Executive Institute, Technical and Policy Issues, available at <<http://www.fe.org/download/IASC+Trustees-Final.pdf>> (lobbying International Accounting Standards Committee regarding selection process for new members of board of IASC).

n34. Choi & Guzman, *supra* note 1, at 949, 924.

n35. Romano, *supra* note 1, at 2396, 2386.

n36. Mahoney, *supra* note 1, at 1456.

n37. Palmiter, *supra* note 9, at 3-4.

n38. See e.g., Roper Center for Public Opinion Poll, Oct. 1984, available in WESTLAW poll database (58% of those polled, and over 80% of those with opinion, have a favorable or highly favorable opinion of the SEC). These results held up during the 1980s, when Roper conducted a number of similar polls. Roper does not seem to have conducted similar polls in the 1990s.

n39. See e.g., Souped-up Offerings, Institutional Investment, Oct. 1, 1998, at 30 (reporting survey finding that most corporate finance officials "think ... [the SEC] fully capable of carefully balancing the interests of investors and issuers in any change of policy and procedure"); Software Publishers Association, Access to Public Information and its Dissemination: Perspectives for Policymakers and the Public in the Information Age (visited Sept. 30, 2000) <<http://www.siaa.net/sharedcontent/govt/issues/gip/gipperspectives.htm>> (trade group representing software companies praising SEC for its implementation of EDGAR).

n40. *17 C.F.R. 230.501-230.506*. See also Securities Act Release No. 6389, 24 S.E.C. Dock. 1166 (Mar. 8, 1982) (adopting Regulation D). From its inception, the SEC has adopted exemptions toward the same end. For a discussion regarding predecessors to Regulation D, see 3 Louis Loss & Joel Seligman, *Securities Regulation* 1388-89 (3d ed. 1999) and Thomas Lee Hazen, *The Law of Securities Regulation* 196 (3d ed. 1995). It should also be noted that the SEC has crafted Regulation D in a maximally rule-bound (as opposed to standard-like) and hence issuer-friendly fashion: specific "safe harbors" allow issuers to reliably sort accredited investors and qualified institutional buyers from others, specific dollar maximums are specified, and specific numbers of unsophisticated investors may be included in limited offerings. These choices seem hard to reconcile with a model of a regulatory agency seeking to maximize its discretion and hence private benefits.

n41. *17 C.F.R. 230.05* (Rule 505); *15 U.S.C. 781(g)(1)* (1934 Act exemption); *17 C.F.R. 240.12g-1* (raising asset threshold for 1934 exemption to \$ 10 million).

n42. *17 C.F.R. 230.506* (Rule 506).

n43. *7 C.F.R. 230.144A*; Resale of Restricted Securities, Securities Act Release No. 6862, [1989-1990 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 84,523* (adopting Rule 144A). Nearly 80% of "junk" bond issues in 1997 were Rule 144A offerings, up steeply from 15% in 1993. See George W. Fenn, Speed of Issuance and the Adequacy of Disclosure in the 144A High-Yield Debt Market, 56 *J. Fin. Econ.* 383, 384 (2000).

n44. Fenn, *supra* note 43 at 385.

n45. *Id.*

n46. See Michael Bender, In Search of the Perfect Market, *Investment Dealers' Dig.*, June 9, 1997, at 18; cf. Lawrence R. Seidman, SEC Rule 144A: The Rule Heard Around the Globe - Or the Sounds of Silence?, 47 *Bus. Law.* 333 (1991) (early commentator doubting that 144A would have a dramatic impact).

n47. See Federal Reserve, Flow of Funds, Rel. Z.1, Table L.213 (visited Sept. 25, 2000) <<http://www.federalreserve.gov/Releases/z1/20000915/z1r-4.pdf>>. Federal data omits hedge funds, which are not obligated to report their full holdings to any government agency. See 2 Board of Governors of the Federal Reserve System, Guide to the Flow of Funds Accounts 850-63 (2000) (discussing sources of data and calculations of corporate equities data). Hedge fund assets have grown rapidly in the last five years, from \$ 50 billion in 1994 to \$ 205 billion in 2000, in funds that report to TASS Investment Research. See Tass Investment Research, The Tass Asset Flows Report, Third Quarter 2000 (visited Sept. 24, 2000) <http://www.tassresearch.com/products_and_services/TASS%20Asset%20Flows%Report%20Q300.pdf>. Based

on current trends in federal and TASS data, a rough projection of total institutional ownership of equities, including hedge funds, by 2005 would be 60-65%.

n48. Data on file with the author from Mergerstat Review shows that over 2400 leveraged buyouts (LBOs) were completed between 1979 and 1999, including 822 going private transactions, for a total deal volume of over \$ 500 billion, which probably understates LBO activity somewhat. On LBOs generally, see Kenneth Lehn & Annette Poulsen, *Leveraged Buyouts: Wealth Created or Wealth Redistributed?*, in *Readings in Mergers and Acquisitions* 99 (Patrick Gaughan ed., 1994) (table 7.1, showing almost \$ 11 billion in LBOs in 1980-1984) and *Leveraged Management Buyouts: Causes and Consequences* (Yakov Amihud ed., 1989). After a downturn in the early 1990s, LBOs (both unit buyouts and going private transactions) are on the upswing, with \$ 31 billion in 1999 alone, up 29% from 1998.

n49. See generally Paul Gompers & Josh Lerner, *The Venture Capital Cycle* (1999); Josh Lerner, *Venture Capital and Private Equity* (2000).

n50. When public securities markets go through a down cycle, venture capitalists rely on mergers and acquisitions (M&A) as the primary "exit" for their investments. One study found that from 1984 to 1989 M&A exits exceeded initial public offerings (IPOs) of venture-capital investments, amounting to as much as 83% of exits in 1989. William D. Bygrave & Jeffrey A. Timmons, *Venture Capital at the Crossroads* 182 (1992).

n51. I thank Howell Jackson and Eric Pan for this data (data on file with author).

n52. Carney argues that the fact that the 144A markets have developed so extensively must mean that public offerings entail high costs, especially from litigation. Carney, *supra* note 17. However, if the problem with public offerings is litigation risk, one would expect issuers to pressure Congress to use its power to modify private rights of action under the securities laws, as was done in the 1995 and 1998 Acts, and not to eliminate the SEC or experiment with the underlying disclosure and public enforcement regime.

n53. See *supra* note 51.

n54. *Id.*

n55. *Id.*

n56. *Id.*

n57. *Id.*

n58. *Id.*

n59. See Jackson & Pan, *supra* note 3, at 50-51 (concluding that the "difference between the demand for public offerings and the demand for Rule 144A offerings is relatively narrow," and that the "pricing advantage of public offerings is not as great as is sometimes assumed," based on interviews of investment bankers and legal practitioners active in transatlantic securities markets).

n60. *Id.* at 51.

n61. 17 C.F.R. 228.

n62. Id. 229.

n63. Id. 230.260.

n64. The 15% figure is based on data from the SEC's web page. See <<http://www.sec.gov>>. See also Charles J. Johnson, Jr., *Corporate Finance and the Securities Laws* 401 (1990) (noting that shelf registration statements rarely trigger SEC review and describing the timetable for a typical securities offering).

n65. *17 C.F.R. 240.10b-5*.

n66. Id. 240.12b-2.

n67. *15 U.S.C.S. 78l* (2000).

n68. Id. 78m.

n69. Id. 78o(d).

n70. *17 C.F.R. 240.12b-31*.

n71. Cf. Carney, *supra* note 17, at 724 (arguing that disclosure depends mainly on offer or firm size, and "within broad categories, then, one size still fits all"). Carney also argues that disclosure documents are more similar than the rules require because of a fear of liability in private lawsuits. See *id.* The data presented in the text - showing huge disparities in the size of offering documents and annual reports - suggests otherwise. To the extent disclosure documents are "over-similar," this seems just as likely to reflect lawyers' efforts to capture economies of scale in preparation of the documentation through the use of boilerplate language, than any rational concern about liability risk. On boilerplate language, see Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, *74 Wash. U.L.Q.* 347 (1996), Michael Klausner, *Corporations, Corporate Law and Networks of Contracts*, *81 Va. L. Rev.* 757 (1995), and John C. Coates IV, *Explaining Variation in Takeover Defenses: Failure in the Corporate Law Market* (June 26, 2000) (unpublished manuscript, available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=237020>).

n72. Adoption of Integrated Disclosure System, Securities Act Release No. 6383 *47 Fed. Reg. 11380* (Mar. 16, 1982) (permitting incorporation by reference for certain issuers).

n73. *17 C.F.R. 230.415* (shelf registration rule). See *Delayed or Continuous Offering and Sale of Securities*, Securities Act Release No. 6423 [1982 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 83,250* (Sept. 2, 1982) (adopting Rule 415 on pilot basis and discussing advantages of shelf registration); *Shelf Registration*, Securities Act Release No. 6499, *48 Fed. Reg. 52889* (Nov. 17, 1983) (adopting Rule 415 on a permanent basis). In 1997, the SEC proposed to extend a version of shelf registration to smaller companies, including small business issuers. See *Delayed Pricing for Certain Registrants*, Securities Act Rel. No. 7393 [1997 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 85,910* (Feb. 20, 1997) (proposing amendment to Rule 430A to permit smaller issuers to delay pricing of securities offerings after registration).

n74. See Johnson, *supra* note 65, at 428-35.

n75. See *17 C.F.R. 230.144A*; Resale of Restricted Securities, Securities Act Release No. 6862, [1989-1990 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 84,523* (adopting Rule 144A).

n76. See Anti-Manipulation Rules Concerning Securities Offerings, Securities Act Release No. 7375 [1996-1997 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 85,871* (Jan. 3, 1997) (revising anti-manipulation rules).

n77. See Use of Electronic Media for Delivery Purposes, Securities Act Release No. 7233, *60 Fed. Reg. 53458* (Oct. 6, 1995) (general interpretive release stating that information delivered electronically may satisfy delivery requirements of federal securities laws if it contains substantially equivalent information as paper delivery); Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisors for Delivery of Information, Securities Act Release No. 7288 [1996-1997 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 3201* (May 9, 1996); Use of Electronic Media for Delivery Purposes, Securities Act Release No. 7289 [1996-1997 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 85,805* (May 9, 1996) (technical amendments to various SEC rules and forms codifying interpretations set out in release numbers 7233 and 7288). See generally Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets (visited Oct. 25, 2000) <<http://www.sec.gov/news/studies/techrp97.htm>> (summarizing SEC's response to technological developments generally).

n78. A recent series of SEC rule changes responding in a remarkably swift fashion to the Report of the Task Force on Disclosure Simplification (Mar. 5, 1996) is an example. See Phase Two Recommendations of Task Force in Disclosure Simplification, Securities Act Release No. 7301 [1996 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 85,815* (May 31, 1996) (proposing to implement Task Force's recommendations to eliminate unnecessary requirements and streamline the disclosure process); Phase Two Recommendations of Task Force on Disclosure Simplification, Securities Act Release No. 7431 [1997 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 85,953* (July 18, 1997) (adopting most of the proposals).

n79. See, e.g., John C. Coffee Jr., The SEC Aircraft Carrier Is Under Attack, N.Y.L.J., Mar. 18, 1999, at 5 ("investment bankers, corporate lawyers, and the bar association committees that they dominate" bringing "concentrated attack" on proposals); Investment Bankers Aim Bomb at SEC's Aircraft Carrier Proposal, *Sec. Week*, Oct. 11, 1999, at 8 (describing letter from Latham & Watkins on behalf of fifteen investment banks attacking proposals); SIA Opposes Aircraft Carrier Filing Requirements, *Fin. Net News*, Mar. 1, 1999 (Securities Industry Association opposition to proposals).

n80. See Maria Shao, Board Backs Off Proposal, *Boston Globe*, Dec. 15, 1994, at 49 (FASB drops proposal after high-tech industry lobbyists organized letter-writing campaigns and, ironically, legislation was introduced in Congress to require the SEC to approve all FASB rule changes).

n81. See Michelle Celarier, Battle of the US Regulators, *Euromoney*, July 1997, at 12 ("Facing mounting pressure ... the SEC offered to review its new procedures sooner than expected.").

n82. Some academics believe pooling accounting can be deceptive. See, e.g., Abraham J. Briloff, Unaccountable Accounting (1972); Abraham J. Briloff, Dirty Pooling, *42 Acct. Rev.* 489 (1967). Other academics believe that fully disclosed accounting policies, such as pooling accounting for mergers, are reflected in stock prices, see, e.g., Hai Hong et al., Pooling vs. Purchase: The Effects of Accounting for Mergers on Stock Prices, *53 Acct. Rev.* 31 (1978), so that pooling is not objectionable on the ground that it is misleading. They nevertheless believe that pooling should be abolished because efficient pricing also means its availability produces no social gain and adds regulatory costs, inducing non-market price-related rent-seeking costs. See, e.g., David Aboody et al., Purchase versus Pooling in Stock-for-Stock Acquisitions: Why Do Firms Care? 26 (Sept. 2000) (unpublished manuscript, visited Apr. 27, 2001) <<http://papers.ssrn.com/sol3/papers.cfm?cfid=524075&cftoken=93474084&abstract id=242439>> (suggesting that pooling creates deadweight social loss).

n83. See *Meddling Politicians*, *Economist*, Oct. 28, 2000 (criticizing Congress for exerting too much political pressure on the SEC regarding pooling accounting, noting that FASB proposal had been delayed further at request of senators).

n84. See Ronald J. Murray et al., *The Adoption of Rule 144A: An Alternative for Companies Entering the U.S. Capital Markets*, 61 *CPA J.* 56 (1991).

n85. See, e.g., Leslie Easton, *Bill to Revise Securities Regulations Ready for Clinton*, *N.Y. Times*, Oct. 2, 1996 ("Legislators, regulators and securities industry executives hailed the [revised] bill [leading to the 1996 Act], which Arthur Levitt, Jr., chairman of the ... [SEC], called "the most significant overhaul of the securities regulatory structure in years."); Rob Wells, *SEC Opposes New Wall Street Deregulation Bill*, *Assoc. Press*, Mar. 6, 1996 (SEC opposes initial bill that led to 1996 Act); Rob Wells, *Senate Passes Bill to Restrict Shareholder Lawsuits in State Courts*, *Assoc. Press*, May 14, 1998 ("bill is backed by the [SEC]," despite opposition from Senator Richard Bryan, who argued that "legislation plunges a dagger into the heart of every small investor in America").

n86. The Williams Act was enacted in Pub. L. No. 90-439, 82 Stat. 954 (codified at 15 *U.S.C.* 78m(d)-(e), 78n(d)-(f)). For the initial bill, see S. 2731, 89th Cong. (1965). See also H.R. 14417, 89th Cong. (1966) (analogous House bill). For the SEC's role in modifying it, see 113 Cong. Rec. 854 (1967) and 112 Cong. Rec. 19003-07 (1966) (SEC Memorandum to the Senate Committee on Banking and Currency).

n87. In the ten years after the passage of the Williams Act, anti-takeover legislation was adopted in thirty-seven states, including Delaware, contrary to the assertion of Easterbrook and Fischel that "for twenty years after the first antitakeover statute was enacted, Delaware had none." Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* 222 (1991). For a list of these first-generation state statutes, see Note, *A Failed Experiment: State Takeover Regulation After Edgar v. MITE Corp.*, 1983 *U. Ill. L. Rev.* 457, 476 n.4. See also John C. Coates, IV, *State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 *N.Y.U.L. Rev.* 806 (applying theories of the corporation to state takeover statutes, reviewing history of statutes and role of Williams Act in preempting first-generation state statutes).

n88. See Gretchen Morgenson, *Many Holes Weaken Safety Net For Victims of Failed Brokerages*, *N.Y. Times*, Sept. 25, 2000, at A1. After Senator Muskie introduced a bill in 1969 to create a federal brokerage insurance agency, securities industry lobbyists successfully lobbied the SEC to draft a compromise bill that resulted in the creation of the Securities Investor Protection Corporation. *Id.* at A24.

n89. *House Subcommittee Hears Views on Organized Crime on Wall Street*, *SEC Today*, Sept. 18, 2000.

n90. See BRT Response to SEC Concept Release - "International Accounting Standards," (June 2000) available at <<http://www.brtable.org/document.cfm/435>>.

n91. *Id.*

n92. See Romano, *supra* note 1, at 2378-80.

n93. See *Selected Disclosure and Insider Trading*, *Securities Act Release No. 7881*, 65 *Fed. Reg.* 51715 (Aug. 23, 2000) (adopting rules regulating selective disclosure to analysts). On the other hand, the new rules may reflect a genuine public-regarding effort to benefit dispersed investors and the SEC's ability to resist pressure from Wall Street interest groups traditionally thought to dominate the SEC.

n94. See, e.g., Romano, *supra* note 1, at 2385 ("This is not to say that state competition is perfect.").

n95. See, e.g., Celarier, *supra* note 82, at 12-13 (Jul. 1997) (quoting a Republican staff member of a legislative committee as saying "if the SEC doesn't voluntarily make the change, there are other means we can use"). For other recent examples of congressional pressure, see Levitt Defends Auditor Independence Proposal Before Senate Subcommittee, *SEC Today*, Sept. 29, 2000 ("Senator Phil Gramm (R-TX), chairman of the Senate Banking Committee, asked for hard evidence that a problem exists before with auditor independence before making ... changes proposed by the SEC. In testimony before the Senate Subcommittee on Securities, SEC Chairman Arthur Levitt ... described the proposal... "); Elisa Williams, Baby Out with Bathwater, *Forbes* 88, Oct. 16, 2000, at 88 (high-tech companies "whined to Congress" about SEC Staff Accounting Bulletin No. 101 on revenue recognition, causing "SEC to push back its implementation deadline").

n96. See Stephen A. Magee et al., *Black Hole Tariffs and Endogenous Policy Theory: Political Economy in General Equilibrium* (1989).

n97. Mahoney, *supra* note 1, at 1456.

n98. *Id.* at 1476.

n99. *Id.* at 1491.

N100. Fox, *supra* note 3, at 1418.

n101. See generally Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest and the Public Agenda: Toward a Synthesis*, 6 *J.L. Econ. & Org.* 167 (1990); Richard Posner, *Theories of Economic Regulation*, 5 *Bell J. Econ. & Mgt. Sci.* 335 (1974). For a somewhat different overview, see Andrei Shleifer, *The Grabbing Hand* (1999) (contrasting the "helping hand" and "grabbing hand" models of government generally). A fourth category of models ("social choice" models) are discussed in Part III, *infra*.

n102. As Peltzman notes, public interest models have "been around in one form or another since Adam Smith," and were the dominant (if often implicit) theory of regulation among economists "until the early 1960's." Sam Peltzman, *The Economic Theory of Regulation after a Decade of Deregulation*, in *Brookings Papers on Economic Activity: Microeconomics* 1, 4 (Martin Neil Baily and Clifford Winston eds., 1989).

n103. See James M. Buchanan & Gordon Tullock, *The Calculus of Consent* (1962); James M. Buchanan et al., *Towards a Theory of the Rent-Seeking Society* (1980). For an example of public choice analysis of the SEC, see Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 *Cardozo L. Rev.* 909 (1994).

n104. See Magee et al., *supra* note 97, at 5 ("Government policies are outside of policymaker control.").

n105. See Sam Peltzman, *Towards a More General Theory of Regulation*, 19 *J.L. & Econ.* 211 (1976); George Stigler, *The Theory of Economic Regulation*, 2 *Bell J. Econ. & Mgt. Sci.* 3 (1971). For examples of capture theory as applied to the SEC, see Phillips & Zecher, *supra* note 7, and Haddock & Macey, *supra* note 7. Capture and public choice theories can be reconciled to the extent that regulators are able to benefit themselves by sharing rents with particular interest groups, either directly or through anticipated future employment by those interest groups.

n106. See Levine & Forrence, *supra* note 102.

n107. This analysis is obviously highly stylized, and is meant simply to illustrate the way that an independent agency creates additional shelter for past regulatory policies. Two caveats: (1) some elected representatives may favor P2 immediately, reducing the time needed to exert political control of the SEC, and (2) once a majority of elected representatives favoring P2 has been voted into office, they could enact new legislation to change the method of choosing SEC commissioners. The first caveat means the absolute effect of an independent agency is less than suggested by the analysis in the text, but does not change the relative point, that independent agencies create stability, enhance interest group power and impose delay on the ability of voters to impose policy changes. The second caveat suggests the limits of independent agencies when policies are important enough to warrant radical change in the structure of government itself, but the general point holds (if less powerfully) for intermediate or modest policy changes.

n108. Of the three other current commissioners, Paul Carey worked as a bond salesman and investment banker for DLJ, and Isaac Hunt worked as a securities lawyer for Jones Day. See Vincent Eng et al., *The Almanac of the Executive Branch* (4th ed. 1999) (providing a history of SEC Commissioners). For post-SEC employment of past commissioners, see, for example, Admission to Official List, Regulatory News Service, Feb. 3, 2000, available in LEXIS, Nexis Library, Regulatory News Service file (noting that Barbara Thomas, former SEC Commissioner, was executive chair of Net Investor, new investment company in the UK), Critical Investments Formed, MAR/Hedge, Dec. 1998, available in LEXIS, Nexis Library, MAR/Hedge file (reporting formation of Critical Infrastructure Fund to be partially owned and controlled by Steven Wallman, former SEC Commissioner and noting that after leaving SEC and prior to joining the fund Wallman was a lawyer for start-up high-tech and internet-based companies), William Hoffman, Tougher Rules Proposed for Day Traders, Traders Magazine, Feb. 1, 2000, available in LEXIS, Nexis Library, Traders Magazine file (noting that Richard Roberts, former SEC Commissioner, represented Electronic Traders Association, umbrella group for day trading firms), and Main Control Names J. Carter Beese, Jr., Former SEC Commissioner, to its Board of Directors, PR Newswire, Mar. 23, 2000, available in LEXIS, Nexis Library, PR Newswire File (noting that Beese, former SEC Commissioner, was president of Riggs Capital Partners, overseeing a \$ 100 million venture capital fund).

n109. U.S. Sec. & Exch. Comm'n, *Opportunities for Lawyers 2* (2000) (on file with author).

n110. See Fox, *supra* note 3, at 1416-19 (arguing that devolution would create disclosure externalities, precisely because devolution would give issuers greater choice over disclosure levels). If the externalities Fox focuses on are serious, and if, as I argue, the SEC is already responsive to industry preferences, one might worry that the current system is also producing socially suboptimal levels of disclosure. However, industry can put political pressure on the SEC only by coordinating a large number of firms that have varying interests in different types of disclosure. Through that coordination, industry may already internalize privately much, if not the full extent, of disclosure externalities, whereas if issuers could pressure disclosure regulators individually by "exiting," as under devolution, they could forego private coordination, hence increasing disclosure externalities.

n111. How much private competition devolution would produce is disputed. See Cox, *supra* note 3, at 123-233; Fox, *supra* note 3, at 1395-1404; cf. Amir N. Licht, *Stock Exchange Mobility, Unilateral Recognition, and the Privatization of Securities Regulation*, 41 *Va. J. Int'l L.* 583 (2001) (discussing increased competition among exchanges). It is not clear, for example, how much competition currently exists in the market for corporate charters, given Delaware's almost total dominance of incorporations by companies willing to incorporate out of their home state. See Coates, *supra* note 72 (noting that Delaware captures 95% of all out-of-state incorporations of firms going public). See also Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Control* (Sept. 2000) (unpublished manuscript, on file with author) (presenting evidence that Delaware is currently obtaining huge levels of rents from its corporate chartering business, suggesting that it has market power); cf. Romano, *supra* note 1, at 2383 (asserting that a competitive regime for corporate charters exists but incorporation in Delaware is simply better for shareholders than incorporation elsewhere due to network effects and a specialized court system and not to competition with other states, thus rejecting the view that federal regulation would be worse scheme than the present one). If devolution produced little or no regulatory competition, any benefits it might provide would be correspondingly smaller than its advocates suggest.

n112. One might also worry that one of the principal advantages of the SEC as regulator - the relative competence and expertise of its staff - would not transfer to the new securities regulators. As regulatory authority is divided, the attractions of employment with the agency fall, as do future rents associated with post-regulatory employment.

n113. Cf. Carney, *supra* note 17, at 720 (wondering why the stability of devolution and the risk of re-regulation should be considered if one thinks devolution unlikely). This consideration is necessary to complete the positive political analysis: if investors and businesses benefit from the existing regime in part because it has been fairly stable (i.e., sheltered from the winds of normal politics), then even if gains from devolution were larger than suggested by the analysis in Part II, it still would not be worth the political candle.

n114. See Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 *U. Chi. L. Rev.* 1047 (1995).

n115. See *id.* at 1049.

n116. See Andrew B. Abel & Ben S. Bernanke, *Macroeconomics* 287 (3d ed. 1995) (noting a landmark 1946 study by Arthur Burns which first documented that "business cycles are a type of fluctuation found in the aggregate economic activity of nations that organize their work mainly in business enterprises," that cycles are "recurrent but not periodic," and "vary from more than one year to ten or twelve years"); N. Gregory Mankiw, *Principles of Economics* 682 (1990) ("Short-run fluctuations in economic activity occur in all countries," "are not ... regular, and ... are almost impossible to predict with much accuracy..."); Steven Weber, *The End of the Business Cycle?*, *Foreign Aff.*, July/Aug. 1997, at 65 (1997) ("Business cycles ... have come to be taken as a fact of life.").

n117. See Mankiw, *supra* note 117, at 683 (figure 31-1, showing recessions are shorter than expansions).

n118. Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* 64 (1994).

n119. See *Exchange Act Release No. 1640, 1938 S.E.C. LEXIS 537* (Apr. 6, 1938).

n120. See Connie Bruck, *The Predators' Ball: The Inside Story of Drexel Burnham and the Rise of the Junk Bond Raiders* (1989); Daniel R. Fischel, *Payback: The Conspiracy to Destroy Michael Milken and his Financial Revolution* (1995); Ronald J. Gilson & Bernard S. Black, *The Law and Finance of Corporate Acquisitions* 37 (2d ed. 1995); James B. Stewart, *Den of Thieves* (1992).

n121. See, e.g., Weber, *supra* note 117, at 65 ("Changes in technology, ideology, employment, and finance ... have reduced the volatility of economic activity in the industrialized world ..."). But see Victor Zarnowitz, *Theory and History Behind Business Cycles: Are the 1990s the Onset of a Golden Age?*, *J. Econ. Persp.*, Spring 1999, at 69 ("The happy prophecy of a growing recession-free economy has been ascribed to a number of different changes in the economy, but none of these suggested reasons is fully persuasive ..."); *Beyond the Business Cycle*, *Economist*, Oct. 23, 1999, at 90 ("It is wrong to conclude that the business cycle is dead..."); Philip A. Klein & John P. Cullity, *Modern Business Cycles: Premature Death* Knell (Jan. 1998) (visited Sept. 26, 2000) <http://www.tcb-indicators.org/articles/eea1998/klein_cullity.htm> ("Although many business cycle recessions since World War II have been mild, the historical record always included mild cases...").

n122. See *Is the Business Cycle Obsolete?* (Martin Bronfenbrenner ed., 1969) (critiquing then-current views that the business cycle was no longer important).

n123. John Galbraith gives one reason why recessions produce scandals: "At any given time there exists an inventory of undiscovered embezzlement in ... the country's businesses and bank... . In depression ... money is watched with a narrow, suspicious eye. The man who handles it is assumed to be dishonest until he proves himself otherwise." John Kenneth Galbraith, *The Great Crash 1929*, 138 (1955).

n124. See Douglas A. Hibbs, Jr., *The American Political Economy: Macroeconomics and Electoral Politics* 1, 6 (1987) ("Macroeconomic policies ... are responsive to and are constrained by the electorate's reactions to economic events[;] voters (predictably) punished Carter and the Democrats in the 1980 elections for the poor economic performance of 1979-1980."); Seymour Martin Lipset & William Schneider, *The Confidence Gap: Business, Labor, and Government in the Public Mind* 61 (1987) ("The state of the economy is one possible explanation for the decline of public confidence [in business and government institutions].").

n125. Joel Seligman, *The Transformation of Wall Street* 5 (1982).

n126. *Id.* at 6.

n127. *Id.*

n128. Thomas K. McCraw, *Prophets of Regulation* 168 (1984) (emphasis added).

n129. See, e.g., Robert S. McElvaine, *The Great Depression: America 1929-1941* 48-49 (1984) ("[A] stock market collapse is unlikely to produce a large depression by itself ... but ... the fragile economy [in 1929] was heavily dependent upon confidence and the spending and investment of the well-to-do ... these were precisely the things that the Crash most effectively undercut."). Cf. Milton Friedman & Anna Jacobson Schwartz, *A Monetary History of the United States 1867-1960* (1963) (arguing that the cause of the Depression was U.S. monetary policy); Peter Temin, *Did Monetary Forces Cause the Great Depression?* (1976) (Keynesian critique of monetary explanation); Kim Clark, *Can You Say "Recession"? How a Bear Market Would Hurt the Economy*, *Fortune*, Dec. 8, 1997, at 28 (Dean of Harvard Business School arguing that future bear market would harm economy); Henry T.C. Hu, *Faith and Magic: Investor Beliefs and Government Neutrality*, 78 *Tex. L. Rev.* 777, 794 (2000) ("There is little question that a crash has the potential for causing a crisis in the real economy.").

n130. See Arthur B. Kennickell et al., *Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances*, 86 *Fed. Reserve Bull.* 1, 15 (table 6) (2000) (showing growth in stock ownership by households); Joseph Tracy et al., *Are Stocks Overtaking Real Estate in Household Portfolios?*, *Fed. Reserve Bank N.Y. Current Issues Econ. & Fin.*, Apr. 1999, at 1-2 (table 1) (showing assets of U.S. households).

n131. Hu, *supra* note 130, at 805-06.

n132. Mahoney, *supra* note 1, at 1455, 1464 (emphasis added). Likewise, "Congress concluded that the NYSE should have banned pools ... [despite] no evidence that they represented manipulations." *Id.* at 1472, 1473. Cf. Galbraith, *supra* note 124, at 166 (1933 and 1934 Acts were passed to eliminate "spectacular excesses" of the 1920s).

n133. Roe, *supra* note 119, at 28-32. See also Galbraith, *supra* note 124, at 155-56 ("In the [1930s] Wall Street was exceptionally well endowed with enemies ..."); Lipset & Schneider, *supra* note 125, at 31 (polls show Americans distrust concentrated wealth and power); McCraw, *supra* note 129, at 162 ("Common folk have ma-

naged to hold the conflicting intuitions that the tale of the stock ticker lay beyond the control of mortal man, but also that the whole process represented a conspiracy engineered by the men of Wall Street.").

n134. See Lipset & Schneider, *supra* note 125, at 283. See also McElvaine, *supra* note 130, at 205 ("The Depression led many intellectuals into believing that some sort of social and ideological apocalypse was at hand ... [and] scores of leading thinkers turned to Marx.").

n135. Lipset & Schneider, *supra* note 125, at 283. See also McElvaine, *supra* note 130, at 207 ("Nearly 60 percent of the poor questioned in a 1935 Fortune survey said that the government should not "allow a man who has investments worth over a million dollars to keep them.").

n136. See The Harris Poll, Confidence in Business and Government Declines, Dec. 16, 1990 (on file with author).

n137. See The Harris Poll #7, Confidence in Leadership of Nation's Institutions Remains Relatively High, Jan. 26, 2000 (visited Oct. 2, 2000) <http://www.harrisinteractive.com/harris_poll/index.asp?PID=3>; The Harris Poll #8, Dramatic Increase in Confidence in Leadership of Nation's Major Institutions, Feb. 11, 1998 (available at <http://www.harrisinteractive.com/harris_poll/index.asp?PID=203>). Of course, even these levels of confidence are not very high, and suggest a long-term, durable decline in public confidence in business as well as institutions generally. See generally Lipset & Schneider, *supra* note 125. In 1997 Gallup polls, stockbrokers and large corporations still earned low levels of public trust: only 18% rated stockbrokers and only 20% rated business executives "high" or "very high" in "honesty or ethics." Gallup News Service, Honesty & Ethics Poll, Dec. 13, 1997 (visited Sept. 22, 2000) <<http://www.gallup.com/poll/releases/pr971213.asp>>. Policemen, pharmacists, and college teachers all did better than 50%; even dentists received "high" or "very high" ratings from 54% of those surveyed. *Id.*

n138. Romano, *supra* note 1, at 2387.

n139. Mahoney, *supra* note 1, at 1454.

n140. Romano, *supra* note 1, at 2372. See also Fox, *supra* note 3, at 1369-95 (discussing intractability of testing value of mandatory federal securities disclosure rules empirically).

n141. This result does not follow if at some tolerable cost a politician can be shown to be overstating his or her claims. When even the most knowledgeable remain uncertain, however, the discipline of careful speech erodes.

n142. See generally Levine & Forrence, *supra* note 102.

n143. See Timur Kuran & Cass R. Sunstein, Availability Cascades and Risk Regulation, *51 Stan. L. Rev.* 683 (1999).

n144. See Young Back Choi, Paradigms and Conventions: Uncertainty, Decision Making and Entrepreneurship 45-61 (1993).

n145. Kuran & Sunstein, *supra* note 144, at 683.

n146. See Fox, *supra* note 3, at 1410-14 (sketching one set of transition costs). Regulatory transition costs may be large even if the resulting regime differs only modestly from the current regime. See Gregory Elliehausen & Barbara R. Lowrey, *The Costs of Implementing Regulatory Changes: The Truth in Savings Act*, 17 J. Fin. Serv. Res. 165, 175 (2000) (finding transition costs to comply with Truth in Savings Act were insensitive to extent of changes required by regulation, suggesting "infrequent major revisions of regulations" is more cost effective than "frequent minor changes").

n147. See, e.g., *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (declaring SEC Rule 19c-4 as regulating corporate governance and thus beyond the SEC's authority).

n148. Indeed, voter majorities have approved the suspension of basic rights and freedoms, and, in the case of Germany during the 1930s, have replaced constitutional democracy largely through "legal" means. The fact that these political remedies have proven disastrous in the past is also no strong basis to assume that future politicians will not push them through: history is filled with disasters reproduced by later generations. A better rejoinder is that if conditions were so bad that disastrous policies would be adopted, any experiment with devolution would be unlikely to have much effect. Still, politics, no less than economics, operates at the margin. If devolution reduces regulation, its failure could discredit deregulation more generally. Since devolution could be portrayed as deregulating Wall Street, populist backlash could be more dangerous.

n149. The Arrow impossibility theorem shows that under certain assumptions, it is theoretically impossible to reach stable political decisions by using simple majority rule as the criterion for decision-making. See Kenneth Arrow, *Social Choice and Individual Values* (1963). Thus, "literally any policy outcome can be obtained from some form of agenda in a simple majority-rule democratic process," and "policies are inherently unstable and transitory." Roger G. Noll, *Comment on Sam Peltzman, The Economic Theory of Regulation after a Decade of Deregulation*, in *Brookings Papers on Economic Activity: Microeconomics* 48, 50 (Martin Neil Bailly and Clifford Winston eds., 1989).

n150. See Kenneth A. Shepsle & Barry R. Weingast, *Structure Induced Equilibrium and Legislative Choice*, 37 *Pub. Choice* 503 (1981). Cf. Jonathan R. Macey, *Organizational Design and Political Control of Administrative Agencies*, 92 *J.L. Econ. & Org.* 93 (1992) (arguing generally that politicians can "hardwire" an agency to generate decisions that reflect their preferences over those of later politicians); Macey, *supra* note 104, at 925 (arguing that shift of authority over securities regulation from Federal Trade Commission to SEC facilitated capture by industry interests by narrowing scope of agency's interests and making its "regulatory clientele ... more homogeneous").

n151. See Levine & Forrence, *supra* note 102 (noting that regulators with "slack" can further the interests of industry or their own sense of the public interest, calling the latter "Burkean").

n152. Cf. Lucinda Kennedy, *IASC is United at Last*, *Acct. Age*, Nov. 25, 1999 (noting SEC role in lobbying for changes in structure of IASC, including twelve full-time board members).