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Teaching Federal Corporate Law

U.S. CORPORATE LAW IS USUALLY CONSIDERED to be rooted in state common law, with securities regulation as its federal counterpart.¹ The traditional law school curriculum mirrors this division. However, a changing economic environment and new regulations put pressure on these categories. This essay proposes one way to integrate responses to the financial crises into the way lawyers are trained: through a course in federal corporate law.²

A rich literature addresses the federalization of corporate law, much of which laments the encroachment on traditionally state law areas.³ What I suggest here is that federal corporate law is productively viewed more expansively, as not limited to securities regulation. Instead it encompasses a diverse and growing set of categories, including such hotly contested topics as federal regulation of executive compensation, federal criminal liability for corporations, and federal corporate charters. Moreover, a federal corporate law course makes a first cut at better aligning the traditional state common law focus of corporate law with the mix of corporate law sources encountered in practice.

Corporate law federalism is an undercurrent even in the basic business associations course, but a focus on federal corporate law allows explicit discussion of this structure. The backdrop is the U.S. tradition of regulating corporate governance at the state level, reflected in strong Supreme Court language to that

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1. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 667 (1974) ("In general, the controls that emerged can be labeled as securities regulation (at the federal level) as distinguished from corporate law (at the state level)."); E. Norman Veasey, *What Would Madison Think? The Irony of the Twists and Turns of Federalism*, 34 DEL. J. CORP. L. 35, 43 (2009) (describing the traditional division between "federal disclosure regulation" and "state primacy over internal corporate affairs").

2. Many of the observations and materials cited in this essay are based on the federal corporate law seminar I taught at the University of Illinois Law School in Fall 2010.

3. See, e.g., Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REG., Spring 2003, at 26, 31 (describing the increased federalization of corporate law and arguing that the "substance of corporate governance standards is appropriately left to the states"); Veasey, *supra* note 1, at 46 ("Sarbanes-Oxley represents a federal incursion into discrete areas of regulation of corporate governance that had been traditionally left to the states under the internal affairs doctrine."); see also Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 591-92 (2003) (arguing that the potential for federal preemption influences Delaware corporate law as much as, or more, than state-to-state competition).

effect⁴ and in the internal affairs doctrine.⁵ Particularly for non-U.S. students, this tradition of state regulation is not obvious. It may even surprise these students that federal corporate law is not at the center of the corporate curriculum.

The other basic building block for this course is understanding the broad federal power to regulate the internal affairs of corporations. This type of course provides a rare opportunity to address the federal government's Commerce Clause powers to make corporate law, which are normally assumed without discussion or relegated to a footnote.⁶

Against the backdrop of these limits and traditions, the question is when the federal government has exercised this power, as a descriptive matter, and when it *should* do so. The history of federal involvement in corporate law includes provisions in recent securities statutes requiring, for instance, independence of directors, but the list is more expansive and longstanding.⁷ It even includes recurring — though currently unfashionable — debates over federal chartering of corporations. The last step in setting up the problem is to ask when corporate law should be federal as a policy matter, and to relate this question to the fundamental and longstanding debate over the effect of competition among jurisdictions.⁸

Federal corporate law, defined by the source of regulation of corporate governance, is a broad category. Moreover, because such federal regulation has not been systematic, it potentially covers disparate legal areas as well. These include:

4. See, e.g., *Cort v. Ash*, 422 U.S. 66, 84 (1975) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.").

5. RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 302 (1971); *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005) ("It is now well established that only the law of the state of incorporation governs and determines issues relating to a corporation's internal affairs.").

6. See U.S. CONST. art. I, § 8; Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1622 n.29 (2005) ("There is no plausible constitutional argument that Congress would not have the power, under the Commerce Clause, to preempt state corporate law with a national corporate law."); *Roe*, *supra* note 3, at 597 ("[A]ll corporate law could be federal law. This is an obvious point, but one that must be borne in mind.").

7. See, e.g., Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons From History*, 106 COLUM. L. REV. 1793, 1800 (2006) (identifying areas of federal regulation of internal affairs).

8. Compare Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 251–52, 290 (1977) (arguing that state competition for corporate charters "will tend toward optimal legal systems" and that state law is "generally preferable to federal"), with Cary, *supra* note 1, at 705 (arguing that jurisdictional competition among the states leads to a "race for the bottom" and that, therefore, federal regulation of corporations should be expanded). See also Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 227–32, 273–81 (1985) (discussing scholarship on the federal-state corporate law debate and analyzing Delaware's competition with other states for corporate charters).

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- Executive compensation⁹
- Federal fiduciary duties¹⁰
- Federal corporate criminal liability¹¹
- Regulation of corporate reorganization (e.g., Williams Act, friendly mergers, tax)¹²
- Voting rights (proxy access)¹³
- Corporate speech¹⁴
- Federal chartering of corporations (including of Fannie Mae, Freddie Mac and banks)¹⁵
- Foreign Corrupt Practices Act¹⁶
- Self-Regulatory Organizations' listing standards¹⁷

9. See, e.g., J. Robert Brown, Jr., *Dodd-Frank, Compensation Ratios, and the Expanding Role of Shareholders in the Governance Process*, 2 HARV. BUS. L. REV. ONLINE 91, 91 (2011), <http://www.hblr.org/2011/10/compensation/> (discussing federal regulation of executive compensation and the use of compensation ratios).

10. See, e.g., Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1197–1201 (1995) (arguing that violation of state-law fiduciary duties should be an element of federal restrictions on insider trading).

11. See, e.g., Geraldine Szott Moohr, *On the Prospects of Deterring Corporate Crime*, 2 J. BUS. & TECH. L. 25, 25–26 (2007) (noting federal regulatory responses to corporate misconduct).

12. See, e.g., Larry E. Ribstein, *Preemption as Micromanagement*, 65 BUS. LAW 789 (2009) (discussing the appropriate scope of federal preemption in the context of the Delaware anti-takeover law and the Williams Act).

13. See, e.g., Jill E. Fisch, *The Long Road Back: Business Roundtable and the Future of SEC Rulemaking*, SEATTLE U. L. REV. (forthcoming 2013) (analyzing the history of the SEC's proposed proxy access rules, which were vacated through litigation).

14. *Citizens United v. Fed. Election Comm'n*, 130 S. Ct. 876 (2010). *Citizens United* has not found a comfortable home in the corporate curriculum. This course offers one possibility.

15. See, e.g., Ralph Nader, *The Case for Federal Chartering*, in *CORPORATE POWER IN AMERICA* 67, 79 (Ralph Nader & Mark J. Green, eds., 1973); Paul E. Lund, *Federally Chartered Corporations and Federal Jurisdiction*, 36 FLA. ST. U. L. REV. 317, 324–25 (2009) (discussing how Congress has expanded the scope of federal chartering of private business corporations beyond banks and railroads to other entities, such as savings associations and credit unions); Roe, *supra* note 3, at 597 (noting that federal chartering was seriously debated in the 1900s, 1910s, 1930s and 1970s).

16. Foreign Corrupt Practices Act of 1977 (FCPA), 15 U.S.C. § 78dd-1 *et seq.* (2006).

17. See, e.g., Robert B. Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 WAKE FOREST L. REV. 961, 968–81 (2003).

The list of subjects that might be included in federal corporate law reflects the broad expanse of federal regulation of internal affairs of business entities (especially public corporations) in the United States. Within a law school, focusing on a few of these specific areas provides context for thinking through systemic choices about the source of regulation.¹⁸ Regulation of executive compensation, for instance, is addressed by state common law, including the judicially developed duty of loyalty.¹⁹ It also involves securities regulation, including disclosure requirements and provisions about say-on-pay.²⁰ Some regulation of executive compensation, however, does not fit comfortably into either category. This includes the use of settlement review by federal judges as a way to police executive bonuses.²¹ It also includes mechanisms put in place as part of the Troubled Asset Relief Program (TARP), which was designed to stabilize financial institutions following the recent financial crisis.²² As part of the program, a Special Master for TARP Executive Compensation (the “Pay Czar”) was tasked with reviewing executive pay at companies that received significant TARP funds.²³ These types of federal corporate law are not easily captured by the traditional categories.

Other complex examples are federal fiduciary duties and federal corporate criminal liability. Although generally fiduciary duties are rooted in state law,²⁴ specific federal definitions of fiduciary duties have developed in the case law about insider trading²⁵ and in the context of investment advisor and broker-dealer fiduciary duties.²⁶ Federal corporate criminal liability might include discussions of

18. The University of Illinois “Federal Corporate Law” seminar covered three specific areas: executive compensation, federal fiduciary duties and shareholder voting.

19. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006); *In re Goldman Sachs Grp., Inc. S’holder Litig.*, No. 5215-VCG, 2011 WL 4826104 (Del. Ch. Oct. 12, 2011) (dismissing a complaint alleging that directors violated their fiduciary duties by approving a compensation package that encouraged excessive risk-taking).

20. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, §§ 951–52, 124 Stat. 1376, 1899 (2010).

21. *SEC v. Bank of America Corp.*, 653 F.Supp.2d 507, 508 (S.D.N.Y. 2009) (rejecting the settlement that Bank of America reached with the SEC for allegedly having made false statements about whether bonuses would be paid to Merrill Lynch executives); *SEC v. Bank of America Corp.*, Nos. 09 Civ. 6829(JSR), 10 Civ. 0215(JSR), 2010 WL 624581, *1, *6 (S.D.N.Y. Feb. 22, 2010) (“while shaking its head,” the court reluctantly approved the settlement).

22. Emergency Economic Stabilization Act of 2008, Pub. L. 110–343, tit. I, 122 Stat. 3765, 3767.

23. See, e.g., Kenneth R. Feinberg, *Symposium on Executive Compensation Keynote Address*, 64 VAND. L. REV. 349 (2011) (detailing the author’s experiences as the TARP special master).

24. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 479 (1977) (rejecting a judicial interpretation of the securities laws that would “overlap and quite possibly interfere with state corporate law”).

25. See, e.g., *Dirks v. SEC*, 463 U.S. 646, 662 (1983) (holding that, in the context of insider trading, the test for breach of fiduciary duty is “whether the insider personally will benefit, directly or indirectly, from his disclosure”).

26. *Jones v. Harris Assocs. L.P.*, 130 S. Ct. 1418, 1426–30 (2010) (detailing the fiduciary duties of investment advisors); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, tit. IX, § 913(g), 124 Stat 1376, 1828 (authorizing the establishment of a federal fiduciary duty for brokers and dealers).

individual versus corporate liability and sentencing.²⁷ It might also address honest services fraud,²⁸ as well as ways governmental civil and criminal actors regulate corporate governance through contract, including through deferred prosecution agreements and other types of settlement agreements.²⁹

Finally, business law is in flux, with a new economic context and new regulation to address this. One way to accommodate these changes in a law school class is to discuss proposed rules or legislation through role playing. For instance, in a seminar on federal corporate law, I randomly assigned roles to students: SEC commissioner, Business Roundtable member, employee, minority shareholder. Students had to advocate for a particular rule or interpretation from their assigned perspective. They also drafted federal legislation establishing shareholder proxy access, an exercise that forced them to deal with the logistics of developing a new rule, including accounting for stricter state laws or contradictory articles of incorporation.

In sum, a course in federal corporate law has the potential to allow explicit discussion of the underlying assumptions of corporate law federalism. It pushes students to apply these broad theoretical concerns in the context of specific case studies. It also paints a complex picture of the changing legal environment for the internal affairs of businesses and for the lawyers that advise these businesses.

27. See, e.g., V.S. Khanna, *Corporate Criminal Liability: What Purpose Does it Serve*, 109 HARV. L. REV. 1477, 1486 (1995–1996).

28. See, e.g., Lisa L. Casey, *Twenty-Eight Words: Enforcing Corporate Fiduciary Duties through Criminal Prosecution of Honest Services Fraud*, 35 DEL. J. CORP. L. 1 (2010).

29. See, e.g., Peter Spivack & Sujit Raman, *Regulating the ‘New Regulators’: Current Trends in Deferred Prosecution Agreements*, 45 AM. CRIM. L. REV. 159 (2008).