

# INTERSTATE COMPACTS IN COMMERCE AND INDUSTRY: A PROPOSAL FOR "COMMON MARKETS AMONG STATES"

Christi Davis\* and Douglas M. Branson\*\*

## INTRODUCTION

At a time when barriers to the free movement of goods and capital are falling worldwide, the states of the United States continue to maintain barriers to commerce and industry. Barriers may be found in nothing more than differing state laws, regulatory requirements, forms, and filing systems that exert subtle influences and so impede free movement of goods and capital.

At other times, states have been proactive—consciously erecting barriers. For example, in 1987, the United States Supreme Court decided *CTS Corp. v. Dynamics Corp. of America*, which upheld Indiana's "second generation" antitakeover statute.<sup>1</sup> Thereafter, forty or more states followed Indiana by adopting second and third generation<sup>2</sup> antitakeover statutes.<sup>3</sup> Undoubtedly, those statutes balkanized the United States, as they were intended, and severely restricted movement and reallocation of capital via the takeover bid.

In contrast, pursuant to the Treaty of Rome, the European Economic Community (EEC) now encompasses fifteen nations and 350 million persons in one union and one market.<sup>4</sup> Within the community, all barriers have been erased and the "four freedoms" have been enhanced.<sup>5</sup> Soon, pursuant to EEC initiatives, promoters may be able to form a pan-European corporation that upon formation will be entitled to do business throughout the new Europe.<sup>6</sup>

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\* B.A. Duquesne University, 1981; J.D., University of Pittsburgh, 1998.

\*\* W. Edward Sell Professor of Law, University of Pittsburgh.

1. *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 94 (1987). *But see* *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), where the Court had declared unconstitutional many aspects of first generation takeover statutes.

2. *See, e.g.*, *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496 (7th Cir. 1989) (upholding third generation Wisconsin "business combination" antitakeover statute). *See also* Frank J. Garcia, *Protecting Nonshareholder Interests in the Market for Corporate Capital: A Role for State Takeover Statutes*, 23 U. MICH. J.L. REFORM 507, 527-28 & nn.114-18 (1990) (cataloging forty states' statutes).

3. *See* Alan R. Palmiter, *The CTS Gambit: Stanching the Federalization of Corporate Law*, 69 WASH. U. L.Q. 445, 538 (1991).

4. *See* TREATY ESTABLISHING THE EUROPEAN COMMUNITY, February 7, 1992, 1 C.M.L.R. 573 (1992).

5. Those are free movement of goods, workers, services and capital. *See* ERIC STEIN ET AL., EUROPEAN COMMUNITY LAW AND INSTITUTIONS IN PERSPECTIVE 369-70, 489-90 (1976).

6. *See* Amended Proposal for a Council Regulation on the Statute for a European Company, 1991 O.J. (C. 176). *See generally* Terence L. Blackburn, *The Societas Europea: The Evolving European Corporation Statute*, 61 FORDHAM. L. REV. 695 (1993) (discussing 1991 proposed European corporation

In addition, the North America Free Trade Agreement (NAFTA) has removed countless barriers to the movement of goods and capital among Canada, the United States, and Mexico.<sup>7</sup> Some South and Central American nations, such as Chile, are beginning to explore opportunities for membership in NAFTA.<sup>8</sup> Similarly, with the Uruguay Round, the General Agreement on Tariffs and Trade (GATT), and the successor World Trade Organization (WTO), barriers to the movement of particular goods fall first by bilateral negotiation, and then subsequently by extension of most favored nation status to other (non-signatory) nations.<sup>9</sup>

On a much narrower scale, in 1974 the Australian states of New South Wales, Victoria, and Queensland formed an Interstate Corporate Commission.<sup>10</sup> Similarly, the Canadian provinces initiated an effort to harmonize company law, securities law, and personal property security law throughout Canada.<sup>11</sup>

To some degree, here in the United States, states do attempt to harmonize their laws through adoption of uniform acts that the National Conference of Commissioners on Uniform State Laws promulgates.<sup>12</sup> Yet not all states adopt the uniform laws the Commissioners promulgate, and, over time, uniform laws may become non-uniform.<sup>13</sup> Many states also adopt Model Acts promulgated by the American Bar Association.<sup>14</sup> Those acts, however, are also subject to

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statute, which is an attempt to create a new form of business organization with a European identity rather than separate identities of the member states).

7. See, e.g., John S. McCain, *Benefits of NAFTA, for the United States, Mexico and the Caribbean*, 14 ARIZ. J. INT'L & COMP. L. 287-88 (1997). See also William C. Graham, *Nafta vis-a-vis the EU—Similarities and Differences and Their Effect on Member Countries*, 23 CANADA-UNITED STATES L.J. 123 (1997).

8. See, e.g., M. Jean Anderson, *Implications of NAFTA's Extension to Chile and Other Countries—a U.S. View*, 23 CANADA-UNITED STATES L.J. 227 (1997).

9. See generally OLIVER LONG, LAW AND ITS LIMITATIONS IN THE GATT MULTILATERAL TRADE SYSTEM (1985); JALIL KASTO, THE FUNCTION AND FUTURE OF THE WORLD TRADE ORGANIZATION (1996); Raymond Vernon, *The World Trade Organization: A New Stage on International Trade and Development*, 36 HARV. INT'L L.J. 329 (1995) (discussing reasons the WTO and related agreements have been accepted to the United States when other efforts have failed).

10. See, e.g., PAUL LATIMER, AUSTRALIAN BUSINESS LAW 605 (1991).

11. See HARMONIZATION OF BUSINESS LAW IN CANADA (Ronald C.C. Cuming, Research Coordinator) (University of Toronto Press 1986).

12. See generally WALTER P. ARMSTRONG, A CENTURY OF SERVICE: A CENTENNIAL HISTORY OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (1991). Examples include the U.C.C. (1962); UNIF. CONSUMER CREDIT CODE (1969); UNIF. EMINENT DOMAIN CODE (1975); and UNIF. PROBATE CODE (1969).

13. See, e.g., Douglas M. Branson, *Collateral Participant Liability Under State Securities Law*, 19 PEPP. L. REV. 1027, 1037-38 (1992). An example is the UNIF. SECURITIES CODE (1956), which is no longer uniform.

14. American Bar Association Model Acts include the REVISED MODEL NONPROFIT CORP. ACT (2d ed. 1988); MODEL INTERSTATE INCOME WITHHOLDING ACT (1984); and the REVISED MODEL BUS. CORP. ACT (3d ed. 1984). The latter is the basic pattern for corporate law in thirty-five or more states but

local variation, which at times may be considerable. Therefore, enactment of a uniform code or model act carries with it no guarantee of uniformity. An attorney representing a multistate business should accordingly be wary of state-to-state variation.

Even model acts and uniform codes only result in harmonization of state laws. Harmonization of laws eliminates just one barrier among states, albeit often a significant one. Differing forms and filing requirements still exist from state to state. These barriers pose additional transaction costs for United States businesses entering, or about to enter, a global economy in which every marginal cost may have to be re-examined.

Through the Supremacy Clause of the United States Constitution,<sup>15</sup> Congress may induce uniformity of regulation and eliminate barriers among states by preemption of state regulation. In fact, Congress recently did so in the field of investment company regulation.<sup>16</sup>

The inconsistencies created by this landscape are clear. Beyond uniform codes or model acts, no systematic research or other effort has gone into elimination of state-to-state barriers in the United States by states themselves. However, the United States Constitution contains an ideal vehicle to standardize commerce and industry, or certain aspects thereof, on a transboundary or regional basis. That vehicle is the interstate compact.

This Article explores the possibility of creating common markets among states, for example, in regions in which local variation already may be minimal. Examples of such regions include the Pacific Northwest states (Alaska, Idaho, Montana, Oregon and Washington), the Great Lakes states (Illinois, Indiana, Michigan, Minnesota, Ohio and Wisconsin), and the New England states (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont). The Article suggests regional regulation of securities offerings, corporate codes, filing systems, and commercial law filing systems as a beginning. As we approach the new millennium, with the globe shrinking daily in an era of increasing globalization, now may be the time for study and

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with substantial local variation. See generally Douglas M. Branson, *Recent Changes to the Model Business Corporation Act: Death Knells for Main Street Corporation Law*, 72 NEB. L. REV. 258, 259-62 (1993) (discussing the Model Business Corporation Act's shift in orientation from "middle of the road" to a more conservative orientation due to dominance by large firm lawyers who have chosen the "pro-corporate manager position at every juncture").

15. See U.S. CONST. art. VI, cl. 2. "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made . . . shall be the supreme Law of the Land, and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." *Id.*

16. See National Securities Market Improvements Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416; see also Rutherford B. Campbell, Jr., *Blue Sky Laws and the Recent Congressional Preemption Failure*, 22 J. CORP. L. 175, 196 (1997); see *infra* notes 115-17 and accompanying text.

implementation of proposals for domestic common markets—"common markets among states."

Part I discusses the history and definition of interstate compacts. Part II discusses particular uses of interstate compacts by the states. Part III discusses the general benefits and detriments associated with the use of interstate compacts to solve regional and transboundary problems. Part IV discusses the proposed use of interstate compacts in the area of securities regulation. Part V discusses the use of interstate compacts to create regional corporation codes. Part VI discusses the use of interstate compacts to reduce inefficiencies in regulating and maintaining certain commercial law notice filing systems.

## I. HISTORY AND DEFINITION OF INTERSTATE COMPACTS

### A. Constitutional Authority for the Use of Interstate Compacts

The United States Constitution provides the authority for states to enter into compacts with one another.<sup>17</sup> Historically, many states have used these compacts to deal with a variety of issues that cross geographical boundaries of the states<sup>18</sup> by providing the opportunity for a regional response to these transboundary problems.<sup>19</sup> In fact, use of the interstate compact pre-dates the Constitution.<sup>20</sup> Well before the Revolutionary War, the colonies used the interstate compact to solve boundary disputes.<sup>21</sup> After the colonies resolved their dispute with a compact, the King had to approve it.<sup>22</sup>

After the Revolution, the Articles of Confederation provided for an appeal to Congress to resolve disputes.<sup>23</sup> Subsequently, in order to prevent political rivalry, Congress added a clause to the Articles requiring that the states present compacts, treaties or agreements between the states to Congress

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17. See U.S. CONST. art. I, § 10, cl. 3 provides in pertinent part: "No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State . . . ."

18. See Carlton James Gausman, Comment, *The Interstate Compact As a Solution to Regional Problems: The Kansas City Metropolitan Culture District*, 45 U. KAN. L. REV. 897, 902 (1997); *infra* notes 46-49.

19. See Gausman, *supra* note 18, at 902.

20. See *id.* at 898. A compact that pre-dates the Constitution is the Virginia-Maryland compact of 1785, governing navigation and fishing rights in the Potomac River, the Pocomoke River and the Chesapeake Bay. See *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 460-61 & n.10 (1978). "Various compacts were entered into between Pennsylvania and New Jersey and between Pennsylvania and Virginia, during the Confederation, in reference to boundaries between them, and to rights of fishery in their waters, and to titles to land in their respective States . . ." *Id.* at 461 n.10.

21. See Gausman, *supra* note 18, at 898; see also Felix Frankfurter & James M. Landis, *The Compact Clause of the Constitution—A Study in Interstate Adjustments*, 34 YALE L.J. 685, 692-93 (1925).

22. See Gausman, *supra* note 18, at 898.

23. See *id.*

for approval.<sup>24</sup> The United States Constitution mirrors the Articles of Confederation, indicating that “[n]o State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State.”<sup>25</sup> This clause reserves significant power to the states to work with neighboring states to resolve a variety of issues before requiring the approval of Congress.<sup>26</sup>

### B. A Description of an Interstate Compact

“An interstate compact is a binding agreement between two or more states.”<sup>27</sup> The agreement is signed by representatives of the states involved and ratified by the signatory states’ legislatures.<sup>28</sup> The agreement “is binding on the signatory states and their citizens.”<sup>29</sup> The agreement will generally, but not always, require congressional approval.<sup>30</sup> Protection from amendment is provided by the Contract Clause of the United States Constitution which prohibits impairment by subsequent state statutes.<sup>31</sup> This protection results in the inability of the signatory states unilaterally to “nullify, revoke, or amend a compact, unless the terms of the compact so provide.”<sup>32</sup> This protection also provides for predictability and stability of the terms of the agreement that states make among themselves. The compact then provides an intermediate level of regulation between federal and state levels.<sup>33</sup>

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24. See *id.*

25. U.S. CONST. art. I, § 10, cl. 3.

26. See Marlissa S. Briggert, Comment, *State Supremacy in the Federal Realm: The Interstate Compact*, 18 B.C. ENVTL. AFF. L. REV. 751, 757 & n.55 (1991) (citing Frankfurter & Landis, *supra* note 21, at 691 & n.25). Briggert notes that Frankfurter and Landis argue that the full potential of the compact clause has not yet been realized because of its phrasing as a negative limitation on the states, resulting in a minimization of the significance of the power. See *id.*

27. *Id.* at 753 (citing H.B. Rubenstein, Note, *The Interstate Compact—A Survey*, 27 TEMP. L.Q. 320 (1954)).

28. See Paul Elliott, *Texas' Interstate Water Compacts*, 17 ST. MARY'S L.J. 1241, 1243 (1986).

29. *Id.*

30. See *United States Steel Corp.*, 434 U.S. at 473; see also *infra* notes 34-38 and accompanying text.

31. See U.S. CONST. art. I, § 10, cl. 1.

32. Elliott, *supra* note 28, at 1243-44.

33. See Briggert, *supra* note 26, at 753; see also Stephen David Galowitz, *Interstate Metro-Regional Responses to Exclusionary Zoning*, 27 REAL PROP. PROB. & TR. J. 49, 108 (1992) (discussing the “intermediate level of government, located somewhere between the federal, state, and local levels, often referred to as the ‘new federalism’”). Proponents of the new federalism model reject federal intervention on a national scale, preferring a regional response to problems of a regional nature. See *id.* Interstate compacts have also been described as providing solutions to problems through “cooperative federalism.” Note, *Cuyler v. Adams and the Characterization of Compact Law*, 77 VA. L. REV. 1387, 1389 (1991).

The necessity of congressional approval depends upon the compact's encroachment upon federal power.<sup>34</sup> The test for whether congressional approval is required is set forth in *United States Steel Corp. v. Multistate Tax Commission*, which upholds *Virginia v. Tennessee* and articulates the test as "whether the [c]ompact enhances state power [at the expense] of the National Government."<sup>35</sup> The Supreme Court in *United States Steel Corp.* upheld the validity of a multi-state tax compact, which Congress had not approved. The purpose of this compact was to assist the audit process for multistate corporations.<sup>36</sup> In upholding the compact, the Court reasoned that the compact did not "authorize member States to exercise any powers they could not exercise in its absence."<sup>37</sup> Generally, however, states do submit interstate compacts to Congress for approval.<sup>38</sup>

If Congress approves an interstate compact, its approval transforms the compact into federal law.<sup>39</sup> This phenomenon is known as the "law of the union" doctrine.<sup>40</sup> The doctrine is now consistently recognized as giving congressionally approved interstate compacts the force of federal law.<sup>41</sup> Commentators have suggested that the states may use the doctrine to circumvent existing federal regulation.<sup>42</sup> The common use of the compact,

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34. This concept was first articulated by the Supreme Court in *Virginia v. Tennessee*, 148 U.S. 503, 519-20 (1893), in which the Court distinguished between compacts that do not encroach upon federal power and those that might interfere with such power. See Briggitt, *supra* note 26, at 757-58. However, the rule implied by the holding, that only compacts that encroach upon federal power need Congressional approval, was uncertain in application. See *id.* at 758.

35. *United States Steel Corp.*, 434 U.S. at 473.

36. See *id.* at 454, 456, 479; see also Gausman, *supra* note 18, at 899.

37. *United States Steel Corp.*, 434 U.S. at 473. After citing a number of Supreme Court cases which upheld the validity of interstate compacts that did not receive Congressional approval, the Court noted that while none of the cases explicitly applied the *Virginia v. Tennessee* test, they reaffirmed its underlying assumption that not all agreements between states are subject to the requirements of the Compact Clause. See *id.* at 469. The Court commented that "[t]he Constitution did not purport to exhaust imagination and resourcefulness in devising fruitful interstate relationships. It is not to be construed to limit the variety of arrangements which are possible through the voluntary and cooperative actions of individual [s]tates." *Id.* at 470 (quoting *New York v. O'Neill*, 359 U.S. 1, 6 (1959)).

38. See, e.g., Gausman, *supra* note 18, at 899.

39. See Elliott, *supra* note 28, at 1244 n.21 (discussing *Cachman v. Nash*, 473 U.S. 716, 719 (1985), in which the Court indicated that a congressionally sanctioned detainer agreement was subject to federal interpretation, and *Cuyler v. Adams*, 449 U.S. 433, 438 (1981), in which the Court indicated that interpretation of an interstate detainer agreement sanctioned by Congress presents a federal question).

40. The doctrine originated in *Pennsylvania v. Wheeling & Belmont Bridge Co.*, 54 U.S. (13 How.) 518, 566 (1852). See also Briggitt, *supra* note 26, at 762. Although the Court has not always followed the doctrine, see, e.g., *People v. Central R.R.*, 79 U.S. (12 Wall.) 455 (1870), the Court ultimately reaffirmed it. See Briggitt, *supra* note 26, at 762 (citing *Delaware River Joint Toll Bridge Comm'n v. Colburn*, 310 U.S. 419 (1940)).

41. See Briggitt, *supra* note 26, at 762.

42. See *id.* at 766. While states have never explicitly used the interstate compact to circumvent existing federal regulation, there does not appear to be any obstacle to doing so. Dissatisfied with an existing law, states could negotiate a compact and obtain congressional approval. Since the compact then

however, is to activate an intermediate level of regulation in circumstances calling for a regional response to a transboundary problem.<sup>43</sup> "Most interstate compacts create an administrative agency called a commission to make rules, gather information and enforce" the compact.<sup>44</sup>

## II. USE OF INTERSTATE COMPACTS

### A. Overview

General uses for interstate compacts have included mining regulation, forest firefighting, water allocation, sanitation, storage of low level radioactive waste, higher education, transportation and taxes.<sup>45</sup> As noted, the first use of the compact between the states was to resolve boundary disputes.<sup>46</sup> The use of compacts grew as the need arose for regional responses to problems that were not contained within the boundaries of a state. One of the first areas in which neighboring states utilized an interstate compact was the facilitation of transportation.<sup>47</sup> For example, the Port Authority of New York and New Jersey devised a compact to administer issues that confronted the port of New York.<sup>48</sup> This compact demonstrates the vast potential of the interstate

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has the effect of federal law, the compact supersedes the earlier federal enactment "just as any other new federal law would." *Id.* Commentators have raised this possibility. See also Rebecca Tsosie, *Negotiating Economic Survival: The Consent Principle and Tribal-State Compacts Under the Indian Gaming Regulatory Act*, 29 ARIZ. ST. L.J. 25, at 58 (1997). Although upon congressional consent the compact supersedes prior federal law, the compact then becomes subject to subsequent federal legislation which could "trump" the compact. See *id.* Attempting to circumvent preexisting federal regulation does not appear to be a worthwhile object of the interstate compact, as states themselves have apparently concluded.

43. See Gausman, *supra* note 18, at 902-03.

44. Jeff Boyce, Note and Comment, *Wrestling with the Bear: A Compact Approach to Water Allocation*, 10 BYU L. REV. 301, 317 (1996). Commissions generally have one or more representatives from every state and a federal representative involved in the compact. See *id.*

45. See Gausman, *supra* note 18, at 901 & n.36. An example of a tax compact is the Multistate Tax Compact, drafted in 1966 and effective August 4, 1967. See *United States Steel Corp.*, 434 U.S. at 454. The purposes of that Compact are:

- (1) [F]acilitating proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes;
- (2) promoting uniformity and compatibility in state tax systems;
- (3) facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and
- (4) avoiding duplicative taxation.

*Id.* at 456. See also *infra* notes 47-49 and accompanying text (discussing transportation); Part II.B. (discussing water allocation).

46. See *supra* note 21 and accompanying text.

47. See Gausman, *supra* note 18, at 900-01.

48. See Briggert, *supra* note 26, at 757. The federal government, which has the Constitutional power to regulate interstate commerce, "ceded to the Port Authority the power to regulate a harbor of vital commercial importance to the entire country." *Id.* See also Frankfurter & Landis, *supra* note 21, at 697-98.

compact, especially one which receives the approval of Congress. Essentially, a compact broadens state powers with the approval of the federal government. However, this potential for increased state power has often drawn Congress's attention to a particular interstate compact.<sup>49</sup>

### B. Allocation of Water Rights

"Interstate compacts have become the most common method of apportioning interstate waters."<sup>50</sup> A member of the National Water Commission has commented that the advantages of using an interstate compact for water allocation are "essentially uncontested."<sup>51</sup> For example, the Bear River Compact provides for the fair allocation of the water rights of the Bear River among the states of Idaho, Utah and Wyoming.<sup>52</sup> The participating states have elected to negotiate an interstate compact to accomplish their objective instead of allowing Congress or the courts to do so.<sup>53</sup>

In water allocation, the use of compacts flourishes, as indicated by the recent passage in the Georgia House of two bills aimed at allocating river water. The river flows through Georgia, Alabama and Florida for each state's drinking, recreation and industrial uses.<sup>54</sup> Again, the use of compacts demonstrates the desire of the signatory states to actively shape their future with predictability rather than allowing others to do so.

### C. Other Recent Uses

Missouri and Kansas have entered into an interstate compact known as the Kansas City Metropolitan Culture District and Bi-State Tax.<sup>55</sup> This compact reflects a regional response to the Kansas City metropolitan area's decline, which is exemplified by the loss of businesses and other

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49. See Briggett, *supra* note 26, at 757.

50. Boyce, *supra* note 44, at 305.

51. *Id.* at 305. The two primary advantages are the ability to plan allocation for an entire river basin and the ability to provide continuity. See *id.*

52. See *id.* By actively handling the allocation through an interstate compact, the states were able to maintain greater control over their interests than had they waited for Congress or the courts to allocate the water rights.

53. See *id.*

54. See *Across the Nation State Lines: News from AZ, CA, FL, GA, MA, MN, or WV*, 6 AMERICAN POLITICAL NETWORK GREENWIRE No. 185, Feb. 4, 1997. Georgia will join two interstate compacts designed to end the tri-state "water war" that began in the early 1990's. See *id.*

55. See Gausman, *supra* note 18, at 897. This compact allows the people of both states to choose whether to participate in a tax that goes to improving the city. See *id.*

organizations.<sup>56</sup> The multistate community faced a common problem many metropolitan areas face— attracting and keeping businesses.<sup>57</sup> The community responded by utilizing the creative solution of an interstate compact to improve the cultural aspects of the region.<sup>58</sup> The “historic union of Missouri and Kansas taxes . . . to renovate Kansas City’s vacant Union Station into a science museum” heralded the crossing of a threshold in recognizing interdependence.<sup>59</sup> “[T]he metropolitan area started talking about growth issues less parochially [and] . . . the region emerged as the new frame of reference.”<sup>60</sup> This innovative response to a problem that crossed the Kansas and Missouri borders reflects an ideal use for the interstate compact. The Cultural District Compact exemplifies the potential that such agreements create for nontraditional, creative solutions to problems that span state boundaries.

Another interesting use of the interstate compact is the Interstate Insurance Receivership Compact, an attempt to enhance the ability of the states to fulfill their responsibilities as insurance regulators.<sup>61</sup> The compact legislation is now law in New Hampshire, California, Illinois, Michigan and Nebraska.<sup>62</sup> The compact is a response to criticism of state insurance regulation, which was said to be particularly weak in the disposition of multistate insurer insolvency. Individual state regulation often results in unequal treatment of policyholders of the same failed insurer due to differences in state laws.<sup>63</sup> Observers expect the compact to produce considerable savings by overcoming costly gaps and unequal treatment of policy holders.<sup>64</sup> This compact is another good example of a response to a problem which crosses state borders, yet it concerns an area where states have

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56. *See id.* at 903.

57. *See id.*

58. *See generally id.* (discussing interstate compacts and bi-state tax plans as a basis for solving problems facing large metropolitan areas restrained by local boundaries); *see also* Jeffrey Spivak, *Bistate Tax Gains Favor: Voters Show 2-to-1 Overall Support for Ballot Issue, But Still Have Concerns*, *Star Poll Finds*, THE KANSAS CITY STAR, Oct. 13, 1996, at A1 (discussing the likely approval by voters of the bi-state tax to convert the landmark Union Station into a Science City museum).

59. Jeffrey Spivak, *Bistate Issue Winning with Hefty Majorities Question Failing Only In Wyandotte County*, THE KANSAS CITY STAR, Nov. 6, 1996, at A1. The taxing district is thought to be the first one to cross a state line. *See id.*

60. Jeffrey Spivak & Chris Lester, *Regional Look at Issues of Area Growth Emerges*, THE KANSAS CITY STAR, Jan. 4, 1996, at A1.

61. *See Legislation Concerning Compacts: Hearings on H.J. Res. 189 Before the Subcomm. on Commercial and Admin. Law of the Comm. on the Judiciary*, 104th Cong. 106 (1996) (statement of Robert G. Lange, Director of Insurance, State of Nebraska) [hereinafter Lange Statement].

62. *See id.* (statement of Leo Fraser, Jr., New Hampshire State Senator).

63. *See id.* at 104.

64. *See id.*

the primary responsibility of regulation.<sup>65</sup> "While still preserving the state-based regulatory system, the [c]ompact presents the opportunity for enhanced coordination among the states and therefore provides a more efficient, less expensive, and ultimately improved regulatory system . . . ."<sup>66</sup>

#### D. Other Examples

States have also utilized interstate compacts in the regulation of electric energy. For example, the Northwest Power Planning Council (Idaho, Montana, Oregon and Washington)<sup>67</sup> is a regional agency whose mission is to plan the region's energy future and to oversee development of a land use plan to protect the Columbia River Basin.<sup>68</sup> Additionally, the Tahoe Regional Planning Authority addresses environmental issues and resource conservation. California and Nevada created the Authority in 1969 by interstate compact, after both states became concerned over the deterioration of Lake Tahoe's water quality.<sup>69</sup>

#### E. The Low-Level Radioactive Waste Policy Act

At least one scheme envisions a series of regional compacts resembling the regional compact for commerce and industry proposed here. Faced with closure of three of the six national sites for low-level radioactive waste disposal, the National Governors' Association Task Force on Low Level Waste proposed that states form regional compacts, with each compact providing for one or more disposal sites for radioactive waste generated in the region.<sup>70</sup> In 1980, the United States Congress passed the Low-Level

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65. Insurance regulation resides at the state level because of a grant of authority from Congress to the states. See Lange Statement, *supra* note 61, at 108.

66. *Id.* A proposal was made to improve the regulation of company law, securities law and personal property security law in Canada using compacts. See generally HARMONIZATION OF BUSINESS LAW IN CANADA, *supra* note 11, at 1-42 (reviewing company law), 77-131 (reviewing securities law), 169-97 (reviewing personal property securities law).

67. See Frank P. Darr, *Electric Holding Company Regulation by Multistate Compact*, 14 ENERGY L.J. 357 (1993) (detailing regulation in the area of electric power production). See generally Dale D. Goble, *The Council and the Constitution: An Article on the Constitutionality of the Northwest Power Planning Council*, 1 J. ENVTL. L. & LITIG. 11 (1986).

68. See Goble, *supra* note 67, at 12; see also Dale D. Goble, *The Compact Clause and Transboundary Problems: A Federal Remedy for the Disease Most Incident to a Federal Government*, 17 ENVTL. L. 785-87 (1987).

69. See *Washington Agenda-Courts-Supreme/Appeals*, FED. INFO. & NEWS DISPATCH, INC./UNITED PRESS INT'L, Feb. 26, 1997, available in 1997 WL 2001251.

70. See Maxwell B. Branson, Comment, *Should Maine Ship Its Low-Level Radioactive Waste to Texas? A Critical Look At the Texas Low-Level Radioactive Waste Disposal Compact*, 19 ME. L. REV. 516, 527-28 (1997).

Radioactive Waste Policy Act.<sup>71</sup> The Act's recitals include a Congressional finding that "low-level radioactive waste can be most safely and efficiently managed on a regional basis."<sup>72</sup> The Act provides that "the States may enter into such compacts as may be necessary to provide for the establishment and operation of regional disposal facilities for low-level radioactive waste."<sup>73</sup> The Act encourages compacts by providing a series of incentives for states that form compacts and penalties for states that do not.<sup>74</sup> Currently, nine regional compacts provide for fifteen waste disposal sites around the country.<sup>75</sup> Although the Low-Level Radioactive Waste Policy Act system of regionalized regulation by compact has raised many other important issues, the system does provide precedent for the series of interstate compacts this article envisions.<sup>76</sup>

### III. BENEFITS AND DETRIMENTS ASSOCIATED WITH THE USE OF INTERSTATE COMPACTS

#### A. Benefits

One benefit brought by regional compact regulation is greater efficiency than federal regulation.<sup>77</sup> Several factors result in increased efficiency. First, the compact can be highly responsive to local and regional needs.<sup>78</sup> States in a region are generally more familiar with the circumstances surrounding a regional problem.<sup>79</sup> Therefore, state officials are more sensitive to the type of regulation needed to address the problem efficiently and effectively.<sup>80</sup>

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71. See Low-Level Radioactive Waste Policy Act, Pub. L. No. 96-573, 94 Stat. 3347 (1980) (amended 1985) (codified as amended at 42 U.S.C. §§ 2021b-2021d (1996)).

72. 42 U.S.C. § 2021d(a)(1) (1996).

73. *Id.* § 2021d(a)(2).

74. The principal incentive-penalty structure was created by the Low-Level Radioactive Waste Policy Amendments Act of 1985, upheld in part and struck down in part in *New York v. United States*, 505 U.S. 144 (1992). See generally Branson, *supra* note 70, at 534-44.

75. See *id.* at 538.

76. For example, earlier this year Congress approved a compact allowing Maine and Vermont to ship radioactive waste to a sparsely populated, largely Hispanic county in West Texas. See H.R. 629, 105th Cong. (1998). Public outcry from local residents and environmental justice activists is credited for the Texas Natural Resource Conservation Commission's denial of the license for the facility. See *NWN Focus: LLW Hurdles, Opportunities; Low-Level Waste: Texas LLW Decision Frustrates Experts, Entices Entrepreneurs*, NUCLEAR WASTE NEWS, Oct. 29, 1998.

77. See Briggett, *supra* note 26, at 753.

78. Because the citizens of the signatory states have access to the compact representatives appointed by the governor, decisions concerning the compact can be tailored to the regional needs voiced by these citizens, rather than reflecting generalized federal policy. See *id.* at 753 & n.16.

79. See *id.* at 753.

80. See *id.* Negotiation is limited to the states directly involved in the problem, providing a better opportunity to tailor the regulation to meet the specific needs and values of the region. See *id.* at 767.

In contrast, federal government agencies and officials are removed from the states' interests, both physically and politically.<sup>81</sup> Federal administrators tend not to emphasize regional concerns,<sup>82</sup> often resulting in federal insensitivity toward important state interests.<sup>83</sup> The interstate compact provides a state with the opportunity to offset federal insensitivity.<sup>84</sup> Additionally, the interstate compact excludes peripheral interests that often hamper effective regulatory action at the federal level.<sup>85</sup>

Another benefit is that compacts tend to respect the "delicate balance among federal, state, and local powers."<sup>86</sup> While providing power to regulate problems that cross state borders, interstate compacts "do so in a manner that safeguards the national interest."<sup>87</sup> While some commentators have suggested that the interstate compact provides the state with an opportunity to circumvent existing federal regulation, most compacts do not do so.<sup>88</sup>

A significant benefit is that the interstate compact broadens individual states' narrow focus by "breaking down fences," allowing states to act together to address regional problems.<sup>89</sup> "Fences may indeed make good neighbors, but the limitation of responsibility that a fence creates can produce a myopia."<sup>90</sup> Making decisions based on the state line boundaries is often problematic because these boundaries frequently reflect neither a natural nor a logical division of the problem that needs to be resolved.<sup>91</sup> When making decisions within state boundaries, states are unlikely to restrict their own citizens' activities solely or primarily to protect a neighboring state's residents.<sup>92</sup> The compact provides the opportunity to make decisions across state boundaries without resorting to nationalization, which has inherent

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81. *See id.*

82. *See id.* For example, federal administrators likely would not have focused federal resources on the Kansas City metropolitan area's loss of business and other organizations. *See supra* notes 55-60 and accompanying text.

83. *See Gausman, supra* note 18, at 767; *see also supra* notes 55-60 and accompanying text.

84. *See id.*

85. *See id.* Furthermore, the individual state's representational power is also increased by using the interstate compact, as the state becomes one voice out of the number of states involved, instead of one voice out of the number of votes in the United States Congress. *See id.*

86. Galowitz, *supra* note 33, at 115.

87. *Id.*; *see also Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30, 40 (1994) (noting that a compact is more than a device for dealing with interests confined within a region as it is also a means of safeguarding the national interest).

88. *See supra* note 42 and accompanying text.

89. Galowitz, *supra* note 33, at 115.

90. Goble, *supra* note 67, at 786.

91. *See id.* This decision making is encouraged by federalism and the "symbolic fences" which it creates. *Id.* at 786-87. The myopia produced by these jurisdictional fences has been referred to by one commentator as "the disease most incident to federalism." *Id.*

92. *See id.* at 787.

limitations in resolving transboundary problems.<sup>93</sup> Furthermore, many transboundary problems are regional in scope, and not of national size or interest.<sup>94</sup>

While respecting the boundaries of federalism and the national interest,<sup>95</sup> interstate compacts enlarge the states' sphere of power.<sup>96</sup> Congressional consent to an interstate compact, required when the compact encroaches upon federal power,<sup>97</sup> transforms the compact into federal law.<sup>98</sup> Approval by Congress effectively provides the state with the authority to regulate in an area which, under the power distribution of federalism, would have been unavailable to the state.<sup>99</sup> This authority gives the state the opportunity to assert its interest in responding to a problem. If the problem is addressed at the federal level, the state may not have the opportunity to assert this interest effectively.

Finally, another benefit of the interstate compact is that it requires action by the compacting states.<sup>100</sup> By entering into an interstate compact—an enforceable contract among the signatory states—each state has a legal right to require the other compacting states to perform.<sup>101</sup> Furthermore, the interstate compact is stable, as no state can unilaterally amend the compact.<sup>102</sup> This combination of enforcement mechanisms and stability makes compacts helpful for long-range planning.<sup>103</sup>

### B. Detriments

One detriment of the interstate compact is the slow approval process.<sup>104</sup> Slow approval rates result from the need for acceptance of the interstate compact by many different governmental units of the contracting states.<sup>105</sup>

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93. See *supra* notes 81-85 and accompanying text.

94. See Goble, *supra* note 67, at 788.

95. See *supra* notes 86-87 and accompanying text.

96. See Brigggett, *supra* note 26, at 766.

97. See *supra* notes 34-38 and accompanying text.

98. See *supra* notes 39-41 and accompanying text.

99. See Brigggett, *supra* note 26, at 766.

100. See Galowitz, *supra* note 33, at 116.

101. See *id.* In contrast to the interstate compact, legislation or administrative solutions do not necessarily vest any particular group with the power to ensure compliance. See *id.*

102. See *supra* notes 31-32 and accompanying text.

103. See Galowitz, *supra* note 33, at 116.

104. See *id.* at 116 & n.299; see also FREDERICK L. ZIMMERMAN & MITCHELL WENDELL, *THE LAW AND USE OF INTERSTATE COMPACTS* 54 (1976).

105. See Galowitz, *supra* note 33, at 116. The negotiation for the first Bear River Compact lasted nine years before the representatives agreed on the allocation of the water rights among the states. See Boyce, *supra* note 44, at 307.

Another detriment is the inability of states to cooperate intensively or continuously.<sup>106</sup> For political purposes, states' chief executives may insist upon negotiation between governors, resulting in intermittent progress. A lack of intensive cooperation may lead to protracted negotiation and disagreement,<sup>107</sup> which in turn exacerbates delay.

Opponents of compacts argue that they violate the Commerce Clause because they encroach upon the supremacy of the federal government, as well as the proper allocation of power between the federal and state governments.<sup>108</sup> Arguably, a particular compact may interfere with the federal government's power to regulate commerce among the states.<sup>109</sup> This problem is most likely to arise in compacts which encroach upon federal power.<sup>110</sup> However, in theory, the congressional consent requirement<sup>111</sup> adequately protects the federal government's interest in regulation of interstate commerce.<sup>112</sup>

Finally, one commentator sees the states' inability to unilaterally amend the compact without the consent of all the signatory states as a detriment.<sup>113</sup> More commonly, commentators perceive that stability to be a benefit for the reasons detailed above.<sup>114</sup>

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106. See Galowitz, *supra* note 33, at 126.

107. See *id.*

108. See *id.* at 125; see also Gausman, *supra* note 18, at 910 (discussing constitutional challenges to interstate compacts when they affect interstate commerce).

109. See Galowitz, *supra* note 33, at 125; see also Gausman, *supra* note 18, at 910.

110. In *United States Steel Corp.*, the court reviewed four components of an argument that the Multistate Tax Compact encroached upon federal supremacy with respect to interstate commerce. See *United States Steel Corp.*, 434 U.S. at 473-76. The court rejected each component of the argument, focusing on the ability of the states to perform the powers in the compact individually if the compact did not exist. See *id.*

111. See *supra* notes 34-38 and accompanying text.

112. See Galowitz, *supra* note 33, at 125; see also Gausman, *supra* note 18, at 911 (discussing that approval of an interstate compact by Congress lessens the chance of a compact falling to commerce clause attack). It is generally felt that if a state could perform a function on its own, performance by interstate compact would not violate the commerce clause. See *id.*

113. See Galowitz, *supra* note 33, at 126-27. The article suggests that this inability makes the interstate compact inflexible. See *id.* Furthermore, it is suggested that this weakness of the interstate compact can be overcome by providing for an expedited amendment process in the original agreement. See *id.*

114. See *supra* notes 102-03 and accompanying text.

#### IV. USE OF INTERSTATE COMPACTS TO REGIONALIZE STATE SECURITIES REGULATION

##### A. *The Problem with State Securities Regulation*

The system for securities regulation in the United States represents a balancing of two objectives: investor protection and capital formation.<sup>115</sup> The result of this balancing has been the development of a bi-level regulatory system for the issuance of federal and state securities.<sup>116</sup> The federal regulatory system primarily utilizes a philosophy of full and fair disclosure.<sup>117</sup>

State securities regulation predates federal regulation. State regulation originated in the early twentieth century in response to perceived fraudulent activities by issuers and promoters.<sup>118</sup> As a result, many states have adopted securities statutes that require offerings to comply with certain substantive standards.<sup>119</sup> The leaders among these states employ a regulatory scheme known as "merit regulation."<sup>120</sup> Under this scheme state authorities may block an offering on the ground that it would create or tend to create an inequity for the citizens of their state.<sup>121</sup> Even with full and fair disclosure, a state can often block an offer on these grounds alone.<sup>122</sup>

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115. See Campbell, *supra* note 16, at 180-85.

116. See Brian J. Fahrney, Comment, *State Blue Sky Laws: A Stronger Case for Federal Pre-emption Due to Increasing Internationalization of Securities Markets*, 86 NW. U. L. REV. 753, 753 (1992). Issuers of securities in the United States must comply with state securities laws in order to sell securities in each state, in addition to the requirements imposed at the national level by the Securities and Exchange Commission. See *id.* This dual regulatory system has been in place since the passage of the Federal Securities Act of 1933 and the Federal Securities Exchange Act of 1934. See *id.*; see also Roberta S. Karmel, *Striking the Right Balance: Federal and State Regulation of Financial Institutions Securities Regulation Blue Sky Merit Regulation*, 53 BROOK. L. REV. 105 (1987).

117. See Campbell, *supra* note 16, at 176. Under this form of regulation, an issuer is legally entitled to sell any security regardless of the price as long as the disclosure requirements of the federal regulations are complied with by the issuer. See *id.* at 177; see also Fahrney, *supra* note 116, at 758 (focus of the Securities and Exchange Commission's effort is to ensure that issuers of securities offer full and fair disclosure).

118. See Fahrney, *supra* note 116, at 755.

119. See Conrad G. Goodkind, *Blue Sky Law: Is There Merit in the Merit Requirements?*, 1976 WIS. L. REV. 79, 80 (1976); see also Campbell, *supra* note 16, at 186. If offerings fail to meet these standards, the securities cannot be sold in the state, even if all material facts are disclosed. See *id.* State blue sky laws requiring substantive qualification of securities are generally referred to as merit regulation. See Mark A. Sargent, *A Future for Blue Sky Law*, 62 U. CIN. L. REV. 471, 473 (1993). A state securities administrator with merit regulation authority may deny registration to securities upon a finding that the offering is not "fair, just and equitable." *Id.*; see also Fahrney, *supra* note 116, at 759.

120. Sargent, *supra* note 119, at 473.

121. See *id.*

122. See Goodkind, *supra* note 119, at 80.

In 1996, Congress enacted the National Securities Markets Improvements Act to address these impediments to offerings.<sup>123</sup> Essentially, the act preempts state authority for merit regulation of certain "covered securities."<sup>124</sup> For the most part, covered securities consist of investment company and high quality issuer securities. Many other securities offerings remain subject to state blue sky regulation,<sup>125</sup> resulting in continued significant dual regulation.

Commentators and practitioners have criticized the American regulatory framework for many years. One criticism is that the disclosures that states require are duplicative of federal requirements.<sup>126</sup> Another major criticism is the inconsistency between state regulations and regulators,<sup>127</sup> which results in costly and time-consuming regulatory compliance.<sup>128</sup> In a public offering of securities, the managing underwriters often must retain a law firm for the sole purpose of "blue skying" the issue. This process includes ensuring that exemptions exist or registration requirements are fulfilled in every jurisdiction where the securities may be offered. Obviously, individual state regulation of securities issuance creates artificial boundaries to capital formation.<sup>129</sup>

Past reform proposals have included federal preemption of state securities regulation and the adoption of uniform laws.<sup>130</sup> Both proposals have largely failed for a variety of reasons. The most significant reasons have been the states' resistance to a reduction of their role in securities regulation,<sup>131</sup> the

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123. See National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416.

124. Campbell, *supra* note 16, at 196-99. Covered securities mainly include registered investment company offerings and securities which are subject to the marketplace exemption. See *id.* Campbell also includes several categories whose descriptions are beyond the scope of this article.

125. See *id.*

126. See Fahrney, *supra* note 116, at 763. Although the state disclosure requirements are above and beyond those of the Securities and Exchange Commission, it is unlikely that the additional disclosures provide investors with substantial additional protection. See *id.*

127. See *id.* at 765.

128. See *id.* The cost of compliance with the inconsistent state regulatory requirements is generally not perceived to outweigh the professed benefit of additional investor protection provided by the states' regulatory scheme. See *id.*

129. State borders do not bear any relationship to the flow of capital. The need to comply with inconsistent state blue sky laws, combined with the costs associated with such compliance, creates a barrier to the flow of capital that is associated merely with the geographical separation of the states and does not have any economic significance.

130. See Fahrney, *supra* note 116, at 753-54 & n.7 (discussing the attempts at uniform state laws in the area of securities regulation), 754 & n.9 (discussing the call for federal legislation to preempt the states' blue sky laws); see also Fahrney, *supra* note 116, at 106 (calling for a uniform regulatory standard to be achieved by either federal-state cooperation or by federal preemption).

131. State governments' stake in blue sky laws is very high, as state securities agencies are cash cows for state general revenues. See Sargent, *supra* note 119, at 499. Fees generated by registration of securities professionals and securities offerings and fines from enforcement actions far exceed the costs of state securities agencies. See *id.* Another reason that states resist a reduction of their role in securities regulation is that states justify their role on paternalistic grounds by professing that the consumer simply

ineffectiveness of federal preemption attempts,<sup>132</sup> and the inconsistent adoption of uniform laws as a result of state territorial interests.<sup>133</sup>

The emergence of a global securities market calls for reform of the United States securities regulatory system.<sup>134</sup> There is currently a lack of regulatory coordination for United States regions to compete in this global market.<sup>135</sup> Despite the worldwide movement toward removing national borders as barriers to capital formation, the United States has fifty internal borders that serve as barriers to capital formation.<sup>136</sup>

Reform will enhance United States competitiveness in the global marketplace. By decreasing compliance costs,<sup>137</sup> regulation may reduce the competitive disadvantage that interstate securities offerings encounter in the United States. By decreasing compliance costs in each individual state, United States issuers will have lower capital costs.<sup>138</sup> On the other hand, there may be local or regional regulatory objectives worth preserving. For example, the Sun Belt states may wish to be more paternalistic. Therefore, regionalization, rather than preemption, may be an ideal route to further reform. As a result, the interstate compact is the best method of achieving regulatory reform of that nature.

### *B. Reform of State Securities Regulation Using the Interstate Compact*

States should consider participating in regionally based interstate compacts that govern the issuance of securities in the region. An issuer of securities in the region need only to comply with the requirements of the

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does not know what is in their own best interest. See Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 395 (1991); see also Sargent, *supra* note 119, at 485. From its inception, blue sky law has defined itself as a means of protecting the individual investor." *Id.*

132. See generally Campbell, *supra* note 16 (discussing the most recent preemption failure by Congress).

133. See Fahrney, *supra* note 116, at 753-54 & n.9.

134. See Sargent, *supra* note 119, at 490-92 (discussing the global securities market and securities internationalization as making blue sky law a "historical anomaly that has outlived its usefulness").

135. See *id.* at 489.

136. See Fahrney, *supra* note 116, at 754. The European Economic Community is attempting to establish a single unified capital market among its member states. See *id.* Additionally, the International Organization of Securities Commissions recommended harmonizing securities offering disclosure requirements among its member countries. See *id.* at 772. The Securities and Exchange Commission itself has made efforts toward achieving international uniformity and cooperation in regulating transnational securities offerings by pursuing a bilateral agreement with Canada and adopting a regulation to encourage the sale of foreign securities in the United States. See *id.* at 775.

137. See *supra* notes 127-28 and accompanying text.

138. The necessity of complying with blue sky laws may currently be even more costly and burdensome for foreign issuers than for domestic issuers. See Fahrney, *supra* note 116, at 775.

compact. The result would be to reduce the issuer's regulatory complexity, reduce costs and make the particular capital market more attractive.

As a creative solution to regional transboundary problems, interstate compacts are used by states to address problems which are not solely within their own borders.<sup>139</sup> Regional participants' grouping in the interstate compact would generally be based on states whose capital markets are linked by economics rather than by current geographic boundaries. Regionalization schemes may be focused more on states with common economic interests and regulatory philosophies. For example, the New England states (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont) or the Pacific Northwest states (Idaho, Montana, Oregon and Washington) may decide that regionalization makes sense for them as well as for issuers of securities. The primary focus should be on the member states having a common perception of the region's collective need for regulation.

Once the appropriate region has been identified, the participating states' representatives negotiate the compact's elements. Components should include the creation of a regional securities agency responsible for overall administration, including rulemaking, enforcement guidelines, and filing systems.<sup>140</sup>

A compact would also eliminate the problem of costly, duplicative, and inconsistent compliance requirements for the registration of securities in the compacting states.<sup>141</sup> While states would resist an attempt at preemption by an amendment to federal securities laws, states may willingly sign a compact that only partially divests them of authority. Such a compact is beneficial to states because it can provide them with significant participation in regional regulation while avoiding forced preemption.<sup>142</sup> Furthermore, the interstate compact should provide for the regional regulation of broker-dealers, a current

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139. See *supra* notes 18-29 and accompanying text; see also discussion *supra* Part II.

140. See, e.g., Elliott, *supra* note 28, at 1246 (discussing the administration of the Rio Grande Compact by a commission); Boyce, *supra* note 44, at 306.

141. See Fahrney, *supra* note 116, at 779 (describing potential amendments to federal securities laws to preempt state blue sky laws).

142. The compact can provide for registration fees that maintain the cash flow to state treasuries that is so much a part of the current scheme. See Sargent, *supra* note 119, at 499 (indicating the indifference of state governments over the type of securities regulation when their real stake is maintaining cash flow).

function of state blue sky laws.<sup>143</sup> Finally, the regional compact should expand the role of enforcement activities of the signatory states.<sup>144</sup>

As an alternative, a compact may achieve a more palatable political result by leaving enforcement out of the compact, relegating this enforcement to participating states. By allowing states to maintain enforcement powers, the compact will provide the signatory states with a continuing paternalistic role of protecting investors within the home state.<sup>145</sup> However, congressional approval of the compact will likely be required, as regulation of the issuance of securities is not a power given solely to the states, but rather granted by Congress to the Securities and Exchange Commission.<sup>146</sup>

## V. USE OF INTERSTATE COMPACTS TO CREATE REGIONAL CORPORATION CODES

### A. *The Problem with Corporation Codes*

State corporate chartering presents another opportunity for interstate compacts to create efficient solutions to transboundary issues. Under the current chartering system, individual states grant charters,<sup>147</sup> and this function is supplemented by judicial interpretation.<sup>148</sup> This state-by-state regulatory

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143. See Fahrney, *supra* note 116, at 781. While such securities dealers are also subject to some duplicative regulation from self-regulatory organizations and the Securities and Exchange Commission, see Sargent, *supra* note 119, at 501-02, it is not essential that this role in regulation be surrendered by the states to the region. Such regulation provides a significant source of revenue for the states and, although it does generate additional cost, it is not generally a "deal killer" or substantial detriment to the flow of capital. *Id.* at 503. Allowing the region to maintain this source of revenue, while alleviating the substantial cost of state-to-state registration of securities, may provide a workable compromise upon which the interstate compact could be based. However, such regulation of broker-dealers could be included in the compact as a regional function with revenue allocated among the signatory states. This will eliminate duplicative regulation.

144. States play a significant role in civil and criminal enforcement of anti-fraud statutes generally not viewed as duplicative. See Sargent, *supra* note 119, at 504. Furthermore, no evidence indicates that anyone wants the state enforcement presence to shrink. See *id.* It is generally perceived that the Securities and Exchange Commission cannot handle the enforcement burden on its own, and that "enforcement at the national level will be effective only if the states continue to assume most of the burden of prosecuting fraud at the local or regional level." *Id.*

145. See National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416; *supra* note 123 and accompanying text.

146. See *supra* notes 34-38 and accompanying text.

147. See Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 885-86 (1990); see also William W. Bratton & Joseph A. McCahrey, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV. 1861, 1867-68 (1995) (describing the system that leaves matters of corporate organizational structure and fiduciary standards to the state).

148. The judicial role in providing a comprehensive body of case law, resulting in greater certainty of legal outcome, is noted as contributing to the success of a state's chartering business. See Alva, *supra*

system results in significant jurisdictional differences among the states.<sup>149</sup> Differences in corporation codes create complexity for the decision maker in choosing where to charter. Corporations are faced with the filing requirements of various state codes, including registration as a foreign corporation for a certificate of authority to transact business in another state, and submission of annual or other reports to the secretary of state.<sup>150</sup> Foreign corporations that wish to do business in the state must also maintain an agent and office in the state.<sup>151</sup>

### *B. Regionalization of State Corporation Codes Through the Interstate Compact*

States should consider becoming participants in regionally based interstate compacts that would undertake the chartering and subsequent regulation of corporations.<sup>152</sup> These interstate compacts would replace the individual signatory states' corporation statutes. The member states will negotiate a regional corporation code. The regionally chartered corporation would be a domestic corporation within the entire region, resulting in a regional focus on business formation along with a reduction in duplicative filing requirements and administrative complexity. Finally, using the interstate compact to develop regional corporation codes would be beneficial if the anticipated rise of regional economic centers competing as the global economy materializes. Futurists postulate that the major players soon will be world class metropolitan areas that will exceed existing jurisdictional boundaries.<sup>153</sup>

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note 147, at 893.

149. See Barry D. Baysinger & Henry N. Butler, *Race for the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law*, 10 J. CORP. L. 431, 440 (1985).

150. See M. Thomas Arnold, *Administrative Aspects of State Corporation Law*, 28 U. RICH. L. REV. 1 (1994).

151. See 36 AM. JUR. 2D *Foreign Corporations* § 263 (1968); see also REVISED MODEL BUS. CORP. ACT § 501 (3d ed. 1984).

152. Advocates of reforming corporate statutes have argued for centralization of some sort, such as federal chartering or federal preemption, that would incorporate significant substantive change in the standards governing the conduct of corporate officers and directors. See Baysinger & Butler, *supra* note 149, at 444.

153. See ROSABETH MOSS KANTER, *WORLD CLASS THRIVING LOCALLY IN THE GLOBAL ECONOMY* 353 (1995). These regions or "operative economies" will spill over existing jurisdictional borders. *Id.* at 22. The metropolitan centers will operate as magnets to attract potential members of the world class. See *id.* at 357-62.

## VI. USE OF INTERSTATE COMPACTS IN COMMERCIAL LAW

Commercial law is another area in which the interstate compact may represent an efficiency enhancing solution. The commercial law system in the United States consists of both state and federal law that is statutory, regulatory and judicially-created, as well as uniform and non-uniform.<sup>154</sup> This section focuses on one major commercial law area: personal property security interests governed by Article 9 of the Uniform Commercial Code (UCC) as adopted by the states.<sup>155</sup> Security interests in some real estate governed by state recording systems<sup>156</sup> and state motor vehicle title systems,<sup>157</sup> such as mobile homes and certain fixtures, might be additional candidates for regionalized recording systems at a later date.

Security interests in personal property generally are documented by a security agreement.<sup>158</sup> "For a security interest in personal property to be enforceable against third parties," the secured party usually must file notice of the security interest with one or more state offices.<sup>159</sup> Notice is created by filing a financing statement.<sup>160</sup> "Each state has developed its own UCC filing system to implement the legislative mandates of the UCC."<sup>161</sup> Due to these mandates, individuals and their counsel face non-uniform requirements, or simply multiple requirements that not only add complexity, but can also be costly if state or local officials reject the filing or if the secured party files with the wrong office.<sup>162</sup> Furthermore, searching databases for notice of previous filings may be difficult due to differences in the numerous systems.<sup>163</sup>

Security interests in real estate in the United States are evidenced by complying with the requirements of the recording system that is governed by

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154. See Charles W. Mooney, *Introduction to the Uniform Commercial Code Annual Survey: Some Observations on the Past, Present, and the Future of the U.C.C.*, 41 BUS. LAW. 1343, 1347 (1986).

155. See Robert M. Lloyd, *Article 9 and Real Estate Law: Practical Solutions for Some Bothersome Problems*, 29 IDAHO L. REV. 583, 583-85 (1993).

156. See John L. McCormack, *Torrens and Recording: Land Title Assurance in the Computer Age*, 18 WM. MITCHELL L. REV. 61, 67 (1992).

157. See Larry N. Miller, *A Proposal for Modernization of the Vehicle Certificate of Title System*, 49 CONSUMER FIN. L.Q. REP. 400 (1995).

158. See Donald A. Wochna, *Personal Property and Security Interests: The Duty to Search*, PRO. & PROP. May/June 1995, at 43.

159. *Id.* "This requirement is set forth in UCC §§ 9-302, 9-304 and 9-305, which have been adopted, without significant modification, by every state." *Id.*

160. The financing statement merely serves as notice that the party identified as a secured party on the financing statement may have rights in the collateral. *See id.* at 43. "The financing statement does not constitute the granting of security interest in the collateral." *Id.* at 43-44.

161. *Id.* at 44. The mandates are not uniform as some states use the UCC filing system as a basis for certain taxes while others make the integrity of the data the primary function of the system. *See id.* The end result is that there are now over 4,000 UCC filing offices in the country. *See id.*

162. *See id.*

163. *See id.*

state law but with compliance at the county level of government.<sup>164</sup> Under this system, attorneys, title companies, and others file documents that affect title to real estate.<sup>165</sup> Although the theme centers around recording of title, as opposed to title itself, "how, where, and by whom these records are kept varies considerably among the states."<sup>166</sup> Commentators criticize the real estate recording system as being unable to provide information regarding the adequacy of security.<sup>167</sup> Furthermore, the current practices in the various jurisdictions are wasteful, unreasonably expensive, and archaic.<sup>168</sup> Undoubtedly, however, local governmental officials, title companies, attorneys, and real estate professionals would strongly resist any attempt at regionalization, despite universal criticism of the current system as unnecessarily complex and uncertain.<sup>169</sup>

Certificates of title evidence security interests in motor vehicles.<sup>170</sup> All states now require perfection of security interests by lien entry on the vehicle's certificate of title.<sup>171</sup> This method is most likely to give notice of the security interest to a purchaser of the collateral.<sup>172</sup> Yet, in order to find notice in the title system, a lender or purchaser may have to search several states' systems.<sup>173</sup> This inefficiency has prompted a movement for a nationalized system to provide for reduced risk for lending institutions, consumers, and the states' departments of motor vehicles.<sup>174</sup> A regionalized system may be a more workable reform.

The primary inefficiency, common to each commercial law filing system, results from the divergent systems that maintain the records that provide proper notice of the security interests. Notice is often difficult to find. Searching is time consuming and costly. Inefficiency arises from the need to understand individual state or county requirements in order to perfect various security interests. There has to be a better way, and regionalization by means of interstate compact may be the solution.

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164. See McCormack, *supra* note 156, at 67.

165. See *id.*

166. C. Dent Bostick, *Land Title Registration: An English Solution to an American Problem*, 63 IND. L.J. 55, 62 (1988). The records that constitute notice under the recording system are themselves widely scattered. See *id.* at 68. They are usually county based. See *id.* The method and overall quality of the system vary widely from jurisdiction to jurisdiction. See *id.*

167. See, e.g., McCormack, *supra* note 156, at 69.

168. See Bostick, *supra* note 166, at 57.

169. See McCormack, *supra* note 156, at 69.

170. See Miller, *supra* note 157, at 400. Motor vehicles are an exception to the general rule of perfecting a security interest in personal property by filing a financing statement. See *id.* at 401.

171. See *id.* at 400.

172. See *id.*

173. See *id.*

174. See *id.* One specific proposal calls for the electronic linking of each database for motor vehicle titles. See *id.*

## CONCLUSION

The use of interstate compacts to eradicate barriers among states would encounter obstacles. States may be unwilling to surrender power or share sovereignty. Filing methods for securities offerings, corporate documents, and real estate documents have changed little in the last five decades.<sup>175</sup> The inertia is great and resistance to change would be vocal and protracted.

Meanwhile, however, technology has advanced. State corporation codes once contained requirements for local as well as state filings. Corporations had to file articles of incorporation and other corporate documents in the county in which the principal place of business or registered office was located. The telephone and the photocopy machine have since made local filing obsolete. The ease of calling the state capital and requesting a photocopy makes it unnecessary to have corporate documents available for viewing at the county seat. States have amended their corporation codes and, in most jurisdictions, local governments have removed filing requirements.<sup>176</sup>

Today the facsimile machine, overnight express mail, and especially the computer have made even state-by-state filing, recording, and regulation obsolete. The interstate compact seems an effective instrument to keep pace with technology and to effect reform in many areas of state law. States have used the interstate compact to solve a variety of transboundary problems. This Article has suggested three more: securities and broker-dealer registration, incorporation, and commercial law filing systems.

To effect any reform, states need to undertake empirical research through legislative hearings or university think-tank research. Only a comprehensive examination could list and quantify cost savings for states and businesses in regionalizing regulation and filing systems. An added benefit is that empirical research might suggest further areas for regulation by interstate compact.

However, empirical research may be unnecessary. State legislatures and chief executive officers work to reduce costs at the margin, consistent with the health and welfare of their citizens. Common markets among states that reduce or eliminate barriers to movement of goods and capital may provide reductions in costs and increased global competitiveness, with little danger posed for citizens. Global competitiveness may begin at home with simple effective measures, rather than with GATT, or the WTO, or negotiations by the U.S. Trade Representative.

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175. See, e.g., Bostick, *supra* note 166, at 62 (describing real estate recordation systems).

176. See TIMOTHY P. BJUR & KENNETH ELKINS, 1A FLETCHER'S CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 156 (Rev. ed. 1993) Most states today provide only for central filing although several states, including New York and Maryland, retain dual filing systems. See *id.*

