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Should New York Courts Hear Certified Questions from the Securities and Exchange Commission?

Verity Winship*

Most states, including New York, allow their highest courts to consider unresolved questions of state law “certified” to them by certain federal courts.¹ In 2007, Delaware expanded its scope of certification, allowing questions to be certified to its highest court by the Securities and Exchange Commission (“SEC”).² This essay evaluates whether New York should follow Delaware’s lead and authorize the New York Court of Appeals to hear certified questions from the SEC.

The essay first examines New York’s current law governing whether and when unresolved questions of New York law can be certified to the New York Court of Appeals. It then describes Delaware’s recent amendment expanding certification to the SEC. The remainder of the essay identifies benefits and costs of amending the New York constitution and rules to allow the New York Court of Appeals to hear certified questions from the SEC. It concludes that, while Delaware’s predominance in number of incorporations may limit the practical impact of such a rule outside of Delaware, such a rule in New York might signal the primacy of state actors in determining corporate law and challenge Delaware’s control over U.S. corporate law.

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1. See Rebecca A. Cochran, *Federal Court Certification of Questions of State Law to State Courts: A Theoretical and Empirical Study*, 29 J. LEGIS. 157, 159 & n.13 (2003) (citing state laws enabling certification procedures); Eric Eisenberg, Note, *A Divine Comity: Certification (At Last) in North Carolina*, 58 DUKE L.J. 69, 71 (2008) (noting that North Carolina is the only state not to have adopted a certification procedure).

2. See Act of May 3, 2007, Pub. Act No. 37, 76 Del. Laws 37 (codified as amended at DEL. CONST. art. IV, § 11(8)).

I. Current New York Law Allowing Certified Questions

Certification of unresolved questions of state law has become widely accepted, with all but one state allowing the state's highest court to answer certified questions from federal judges.³ In New York, a constitutional provision requires the New York Court of Appeals to adopt a rule allowing certification "by the Supreme Court of the United States, a court of appeals of the United States or an appellate court of last resort of another state . . ."⁴ Questions may be certified if they "may be determinative of the cause then pending in the certifying court and . . . are not controlled by precedent in the decisions of the courts of New York."⁵

Pursuant to this constitutional provision, the New York Court of Appeals has adopted a court rule of practice allowing such certification.⁶ The rule states that the U.S. Supreme Court, any U.S. Court of Appeals, or state courts of last resort may certify a "determinative" or "dispositive" question of law to the New York Court of Appeals for which "no controlling precedent of the [New York] Court of Appeals exists."⁷ The New York Court of Appeals has accepted such certified questions. For instance, the Court of Appeals decided whether a Saudi Arabian citizen was "transacting business" in New York such that he was subject to personal jurisdiction under New York's long-arm statute after the federal appellate court certified that question to the Court of Appeals.⁸ It has also rejected certified questions when, for instance, they were not dispositive or were unlikely to arise in state court.⁹

3. Eisenberg, *supra* note 1, at 71.

4. N.Y. CONST. art. VI, § 3(b)(9).

5. *Id.*

6. See N.Y. COMP. CODES R. & REGS., tit. 22, § 500.27(a) (2009).

7. *Id.*

8. Ehrenfeld v. Bin Mahfouz, 881 N.E.2d 830, 831-32 (N.Y. 2007). *See also* Judith S. Kaye & Kenneth I. Weissman, *Interactive Judicial Federalism: Certified Questions in New York*, 69 FORDHAM L. REV. 373, 401 (2000) (evaluating New York's experience with certification from federal courts).

9. *See, e.g.,* Yesil v. Reno, 705 N.E.2d 655, 656 (N.Y. 1998), *declining certification* from No. 97-2629, 1998 U.S. App. LEXIS 38253 (2d Cir. Sept. 18, 1998) (declining to hear a certified question concerning personal jurisdiction over a federal immigration official because the issue was not dispositive and was unlikely to arise in state court).

II. The Delaware Example

Delaware, like most states, allows certification of questions to its highest court. According to Delaware's constitutional provision and the court rule it enabled, the Delaware Supreme Court—the Delaware equivalent of the New York Court of Appeals—may hear certified questions from the U.S. Supreme Court, U.S. Courts of Appeals, and other states' courts of last resort.¹⁰ Unlike the New York Court of Appeals, it may also hear certified questions from other Delaware courts and U.S. District Courts.¹¹ Moreover, the standard for certification is not that the question be “determinative” or “dispositive,” but rather that it “appear[] to the [Delaware] Supreme Court that there are important and urgent reasons for an immediate determination of such questions by it.”¹²

In the summer of 2007, the Delaware legislature broadened the category of certified questions even further by amending the Delaware Constitution to allow the Delaware Supreme Court to hear certified questions from the SEC.¹³ The legislative history of these amendments is meager. The Senate's version of the bill says merely that “[t]he purpose of this amendment is to add the United States Securities and Exchange Commission to the list of entities that may certify questions of law to the Delaware Supreme Court,”¹⁴ and that “[m]ore than half of the publicly traded companies in the United States are Delaware corporations.”¹⁵

These amendments to Delaware's laws affect only the reach of Delaware's courts; nothing in them can force the SEC to take advantage of this new possibility. Nonetheless, the SEC chose to certify a question to the Delaware Supreme Court in June

10. See DEL. CONST. art. IV, § 11(8); DEL. SUP. CT. R. 41(a)(ii).

11. See DEL. SUP. CT. R. 41(a)(i), (ii).

12. DEL. CONST. art. IV, § 11(8). See also DEL. SUP. CT. R. 41(a), (b).

13. See Act of May 3, 2007, Pub. Act No. 37, 76 Del. Laws 37 (codified as amended at DEL. CONST. art. IV, § 11(8)). The Rules of the Supreme Court of the State of Delaware were subsequently amended to conform to this constitutional amendment. See DEL. SUP. CT. R. 4 (a)(ii). See also J.W. Verret, *Federal vs. State Law: The SEC's New Ability to Certify Questions to the Delaware Supreme Court*, CORP. GOVERNANCE ADVISOR, Mar./Apr. 2008, at 12 & n.1.

14. S. 62, 144th Gen. Assem., 76 Del. Laws 37 (2007).

15. *Id.*

2008,¹⁶ and the Delaware Supreme Court accepted and decided the issue.¹⁷ The certified question in *CA, Inc. v. AFSCME Employees Pension Plan* (“*CA, Inc.*”), was whether a proposed corporate bylaw exceeded shareholder powers under state law or would otherwise violate state law.¹⁸

Under Section 14(a) of the Securities Exchange Act of 1934, the SEC is tasked with regulating proxy solicitations.¹⁹ Companies can exclude shareholder proposals from proxy materials only if they fall into one of the categories listed in the SEC’s proxy rules.²⁰ Two bases for exclusion explicitly involve state law. The proposal may be excluded if it “is not a proper subject for action by shareholders under the laws of the jurisdiction of the company’s organization,”²¹ or “[i]f the proposal would, if implemented, cause the company to violate any state, federal, or foreign law to which it is subject.”²² Companies seeking to exclude a proposal request that the SEC issue a letter indicating that it will not take enforcement action against the company for omitting the proposal.²³ Although technically non-binding, these SEC “no-action letters” comprise a relatively well-developed source of interpretations of the securities laws.²⁴

To evaluate the request for a no-action letter in *CA, Inc.*, the SEC had to determine whether the proposal mandating reimbursement of dissident shareholders’ proxy solicitation expenses was a proper subject for action by shareholders under

16. See SEC. EXCH. COMM’N, CERTIFICATION OF QUESTIONS OF LAW ARISING FROM RULE 14A-8 PROPOSAL BY SHAREHOLDER OF CA, INC. (June 27, 2008), *available at* <http://www.sec.gov/rules/other/2008/ca14a8cert.pdf> [hereinafter SEC. EXCH. COMM’N, CERTIFICATION]. See also *CA, Inc.*, SEC No Action Letter, 2008 SEC No-Act. LEXIS 495, at *1-2 (June 27, 2008) (informing parties to the action of the question’s certification to the Delaware Supreme Court).

17. See *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. 2008).

18. *Id.* at 231. See also SEC. EXCH. COMM’N, CERTIFICATION, *supra* note 16.

19. 15 U.S.C. 78n(a) (2006).

20. See 17 C.F.R. § 240.14a-8(i) (2009).

21. *Id.* § 240.14a-8(i)(1).

22. *Id.* § 240.14a-8(i)(2).

23. See SEC. EXCH. COMM’N, DIV. OF CORP. FIN., STAFF LEGAL BULLETIN NO. 14, SHAREHOLDER PROPOSALS (2001), *available at* <http://www.sec.gov/interp/legal/cfslb14.htm>.

24. See Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 CORNELL L. REV. 921 (1998) (arguing that courts should defer to regulatory positions in no-action letters only when they are persuasive).

Delaware law and whether, if adopted, it would cause the company to violate Delaware law.²⁵ Each side submitted an opinion from a Delaware law firm concerning the content of Delaware law.²⁶ Faced with competing interpretations, the SEC certified the question to the Delaware Supreme Court,²⁷ which decided that shareholders have the power to pass bylaws but that the proposal, as phrased in *CA, Inc.*, would violate Delaware law because it could prevent the board from exercising its fiduciary duties to decide whether reimbursement was appropriate at all.²⁸

III. The Practical Consequences of Following Delaware's Example

One of the basic questions is whether the SEC could or would certify a question to New York's—as opposed to Delaware's—courts. The limited circumstances in which the SEC considers state law and the predominance of Delaware incorporation among U.S. corporations suggest that certification by the SEC to New York or other non-Delaware courts would be infrequent.

First, the primary task of the SEC is to enforce the federal securities laws, and not to determine state law.²⁹ Nonetheless, the SEC sometimes must determine state law, as the single certified question to date illustrates. Whether a shareholder proposal can be excluded from a proxy statement may turn on its consistency with state law.³⁰ According to the applicable SEC regulation, the subject of the shareholder proposal must be “a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization,” whether New York, Delaware, or some other jurisdiction.³¹ This requirement means that the question could arise in any state of incorpora-

25. SEC. EXCH. COMM'N, CERTIFICATION, *supra* note 16.

26. *See id.*

27. *See id.*

28. *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 237, 240 (Del. 2008).

29. *See, e.g.*, SEC. EXCH. COMM'N, 2008 PERFORMANCE AND ACCOUNTABILITY REPORT 8, available at <http://www.sec.gov/about/secpar/secpar2008.pdf>.

30. *See CA, Inc.*, 953 A.2d at 231; SEC. EXCH. COMM'N, CERTIFICATION, *supra* note 16.

31. 17 C.F.R. § 240.14a-8(i)(1) (2009).

tion, including New York. However, it also suggests that the frequency with which the opportunity for certification arises depends on the number of incorporations. Notably, opportunities for certification by the SEC are likely less frequent (or at least less varied) than those for federal courts, which often have to decide issues of state law because of jurisdictional and *Erie*-driven choice-of-law rules.³² These limits on what the SEC could certify are applicable to all states, including Delaware. Of course the SEC could choose not to certify anything. The point is just that the pool of cases in which the SEC could exercise its discretion to certify is limited.

Second, Delaware's overwhelming predominance in number and percentage of incorporations nationwide may make adoption of an SEC certification rule less pressing in any other jurisdiction. A recent study found that, as of the beginning of 2000, 57.75% of corporations were incorporated in Delaware, with the remaining spread among the other, often their home, states.³³ Only 226 of the publicly held corporations studied were incorporated in New York, as opposed to Delaware's 3,771.³⁴ New York incorporations amounted to 3.46% of all incorporated and publicly traded firms, which, given Delaware's overwhelming presence, was the third highest percentage after Delaware and California.³⁵ These numbers suggest that the SEC will face fewer interpretations of New York law and that the SEC might be more likely to certify questions to the Delaware Supreme Court because its decisions will affect more companies and because it has cultivated a particular expertise in corporate law.³⁶

IV. The Symbolic Value of Expanded Certification

Although the number of incorporations in New York may be low, allowing certification from the SEC to the New York Court

32. See Jonathan Remy Nash, *The Uneasy Case for Transjurisdictional Adjudication*, 94 VA. L. REV. 1869, 1873-75 (2008).

33. Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 390 (2003) (analyzing a dataset of publicly traded firms headquartered and incorporated in the United States).

34. *Id.*

35. *Id.*

36. See, e.g., Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1062-63 (2000).

of Appeals might promote other values. In particular, such an amendment would signal to the SEC (and potentially to Delaware) that the New York state courts are available to resolve these state-law corporate issues.

Certification in general has been touted as “sav[ing] time, energy and resources and help[ing] build a cooperative judicial federalism.”³⁷ When federal courts certify questions to state courts, the efficiency rationale is that certification avoids abstention.³⁸ At least in the context of no-action letters, it is not clear that the alternative to certification is abstention—the SEC has long issued these letters on the basis of submitted opinions of local counsel.³⁹ Moreover, in practice, the efficiency rationale may not be that persuasive in either case. At least one judge has suggested that federal courts often certify questions where they would not abstain and that certification may simply be an additional interruption.⁴⁰

As for “cooperative federalism,” the issue is whether a federal or state institution appropriately decides questions of state corporate law. Certification enhances the control of state courts by affording those courts additional opportunities to address state-law questions. It does not, however, affect which entity controls the content of state law. If a federal court or a federal agency opts not to certify a question, its resulting decision of state law does not bind state courts, although it may be persuasive.⁴¹ State courts could decide (and several have decided) that the federal courts got state law wrong and can proceed to set them right.⁴² Similarly, it is difficult to say that a decision by the SEC whether to issue a no-action letter based on its interpretation of state law affects the content of state law beyond the actions of the immediate parties. No-action letters do not bind Delaware courts as to Delaware law (or New York courts as to New York law).⁴³

37. *Lehman Bros. v. Schein*, 416 U.S. 386, 391 (1974).

38. See *Kaye & Weissman*, *supra* note 8, at 381.

39. See *Nagy*, *supra* note 24, at 923.

40. Bruce M. Selya, *Certified Madness: Ask a Silly Question . . .*, 29 SUFFOLK U. L. REV. 677, 687-88 (1995).

41. See, e.g., Jonathan Remy Nash, *Resuscitating Deference to Lower Federal Court Judges' Interpretations of State Law*, 77 S. CAL. L. REV. 975, 976 (2004).

42. *Id.* at 978-79.

43. See *Nagy*, *supra* note 24, at 923-24.

The nature of the questions, however, may make these additional opportunities particularly valuable to states. Corporate law—more so than many other areas of the law—has traditionally been driven by state law. As the Supreme Court has repeatedly emphasized, “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.”⁴⁴ Moreover, the questions raised within corporate law may have particularly high stakes; *CA, Inc.*, for example, concerned the fundamental relationship of shareholders and directors.⁴⁵

In addition to the assertion of state control over corporate law, certification concerns different states’ control over corporate law. One way of viewing this proposed amendment would be as a challenge to the predominance of Delaware in forming U.S. corporate law. In the long-standing academic debate over whether states compete over corporate charters and the effects of such competition,⁴⁶ some commentators have concluded that states do not actually compete for charters,⁴⁷ but in a way that is beside the point. Whether such an amendment would make sense for New York depends how much the legislature values asserting that state courts are the appropriate forum for novel and difficult questions of state corporate law and signaling that this is as true for New York as it is for Delaware.

44. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977) (emphasis omitted) (quoting *Cort v. Ash*, 422 U.S. 66, 84 (1975)).

45. *See CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 231 (Del. 2008).

46. *See* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) (arguing that Delaware had led a “race to the bottom” in corporate law by providing law attractive to managers); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977) (arguing that state competition for corporate charters leads to legal rules that provide value to shareholders).

47. *See, e.g.*, Mark Roe, *Delaware’s Competition*, 117 HARV. L. REV. 588 (2003) (arguing that Delaware’s real competition comes from the federal government, not other states).

V. The Costs of Amending New York's Certification Process

The process for amendment is not costless. As noted above, the power of New York courts to hear certified questions is rooted in a constitutional provision enabling court rules of practice and thus would require constitutional amendment.⁴⁸ The New York Constitution details mandatory procedures for such amendment, whether by the legislature or constitutional convention.⁴⁹ The basis of the certification power may affect other states' evaluation of whether adding the SEC is worth the trouble. In particular, states where the power of the state courts to hear certified questions does not require constitutional amendment, but rather is based in statute, court rules, or inherent powers, may consider the benefits to outweigh the costs.⁵⁰

Another difficulty is the content of the amended text. Taking Delaware's lead and adding the SEC to the list might not be enough. For one, it may be difficult to say that a question is "determinative" or "dispositive" when it concerns an SEC no-action letter, which is nonbinding. This limitation may, in turn, renew earlier concerns that certification gives rise to advisory opinions.⁵¹ Finally, to make certification attractive to the SEC, a commitment to speed might be required. For example, Delaware decided the *CA, Inc.*, case in three weeks, and the idea that the question requires "immediate determination" is built into the text of the Delaware provision.⁵²

VI. Conclusion

An amendment to allow the New York Court of Appeals to hear certified questions from the SEC may have symbolic value, regardless of the frequency with which such questions arise. Whether New York should follow in Delaware's footsteps de-

48. See N.Y. CONST. art. VI, § 3(b)(9).

49. See N.Y. CONST. art. XIX; 20 N.Y. JUR. 2d *Constitutional Law* § 6 (2008).

50. See, e.g., ARIZ. REV. STAT. ANN. § 12-1861 (2008); KAN. STAT. ANN. § 60-3201 (2008); MASS. SUP. JUD. CT. R. 1:03.

51. See Kaye & Weissman, *supra* note 8, at 388 (noting that the first reaction of the New York Court of Appeals to a proposed certification process was that it involved impermissible advisory opinions).

52. See *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 231 (Del. 2008).

pendes primarily on how highly the New York legislature values asserting the primacy of state actors over federal actors in the area of corporate law and challenging Delaware's tight hold on the development of corporate law in the United States.