



3-2020

The Race to the Middle

William Magnuson

Texas A&M University School of Law

Follow this and additional works at: <https://scholarship.law.nd.edu/ndlr>



Part of the [Antitrust and Trade Regulation Commons](#), and the [State and Local Government Law Commons](#)

Recommended Citation

95 Notre Dame L. Rev. 1183 (2020).

This Article is brought to you for free and open access by the Notre Dame Law Review at NDLScholarship. It has been accepted for inclusion in Notre Dame Law Review by an authorized editor of NDLScholarship. For more information, please contact lawdr@nd.edu.

THE RACE TO THE MIDDLE

William Magnuson*

How does federalism affect the quality of law? It is one of the fundamental questions of our constitutional system. Scholars of federalism generally fall into one of two camps on the question. One camp argues that regulatory competition between states leads to a “race to the bottom,” in which states adopt progressively worse laws in order to pander to powerful constituencies. The other camp, conversely, argues that regulatory competition leads to a “race to the top,” incentivizing states to adopt progressively better laws in the search for more desirable outcomes for their constituencies. Despite their apparent differences, however, both the race-to-the-bottom camp and the race-to-the-top camp share one fundamental assumption—that federalism leads to extremes. In other words, when states compete on regulatory regimes, they inevitably race to high or low levels of regulation, hoping to outdo one another by distinguishing themselves from their peers. This Article, however, argues that both of these federalism models fail to account for another powerful dynamic that pushes states, not to distinguish themselves from the crowd, but rather to fit into it. This “race to the middle” leads states to adopt regulations that are similar, or even identical, to the regulations adopted by large numbers of other states. The resulting race to the middle causes state law to gravitate toward mediocre but satisfactory regulatory outcomes, not efficient or inefficient ones. The Article demonstrates how the “race to the middle” is driven by four interrelated factors: first, the informational benefits that accrue to states that adopt well-established legal regimes; second, the demand by constituents, and in particular corporations, for familiar regulatory regimes; third, the network effects from interoperable regulatory regimes; and fourth, the reduced risk of federal intervention that arises when states adopt mainstream regulatory structures. The Article concludes by assessing the implications of the race to the middle for theories of federalism and democratic governance.

INTRODUCTION 1184

I. THE RACES TO THE EXTREMES..... 1187

 A. *Federalism and Regulatory Competition*..... 1188

 B. *The Race to the Bottom*..... 1191

© 2020 William Magnuson. Individuals and nonprofit institutions may reproduce and distribute copies of this Article in any format at or below cost, for educational purposes, so long as each copy identifies the author, provides a citation to the *Notre Dame Law Review*, and includes this provision in the copyright notice.

* Associate Professor, Texas A&M University School of Law; J.D., Harvard Law School; M.A., Università di Padova; A.B., Princeton University. The author wishes to thank Jonathan Macey, Rebecca Tushnet, Norman Spaulding, Jill Fisch, Andrew Tuch, Maureen Brady, Zachary Clopton, George Georgiev, Matthew Turk, Kish Parella, Jared Ellias, Yonathan Arbel, Matthew Shapiro, Robert Anderson, Lynn LoPucki, Vanessa Casado Pérez, and participants at the Yale/Stanford/Harvard Junior Faculty Forum for helpful advice and guidance.

C. <i>The Race to the Top</i>	1197
II. THE RACE TO THE MIDDLE	1200
A. <i>The Benefits of the Middle</i>	1201
1. Informational Effects	1201
2. Familiarity	1205
3. Interoperability	1208
4. Intervention	1212
B. <i>The Consequences of the Race to the Middle</i>	1215
C. <i>Conditions for Races to the Middle</i>	1221
III. IMPLICATIONS OF THE RACE TO THE MIDDLE	1225
A. <i>Laboratories of Democracy</i>	1226
B. <i>Tyranny of the Majority</i>	1227
C. <i>Voting with Your Feet</i>	1229
CONCLUSION	1230

INTRODUCTION

How does federalism affect the quality of state law? It is a difficult question that scholars have struggled with, and disagreed about, for decades. At its core, though, the question is a simple one. States are free to establish their own laws in a wide variety of areas and thus inevitably face choices about which laws to adopt. In making these choices, states are informed by the laws in place in other states. Their eventual choices will, in turn, inform the choices that other states make about their own laws. Given this dynamic, how should we expect states to act?

Scholars that have addressed the question generally fall into one of two camps: those who see federalism as leading to a “race to the bottom”¹ and those who see it as leading to a “race to the top.”² The race-to-the-bottom

1 See Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992) (arguing that state charter competition leads to undesirable corporate law rules in a number of areas); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 705 (1974) (describing the “race for the bottom, with Delaware in the lead” in corporate-governance standards); Lynn M. LoPucki, *Corporate Charter Competition*, 102 MINN. L. REV. 2101, 2104 (2018) (arguing that charter competition’s “principal effects are to deregulate corporations and shield them from the democratic reimposition of regulation”); Donald E. Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545, 555–56 (1984) (arguing that federalism leads to a number of endemic defects in corporate-governance laws); Richard B. Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 YALE L.J. 1196, 1212 (1977) (arguing that individual state refusals to adopt high environmental standards lead to a tragedy of the commons); Peter P. Swire, *The Race to Laxity and the Race to Undesirability: Explaining Failures in Competition Among Jurisdictions in Environmental Law*, 14 YALE L. & POL’Y REV. (SYMP. ISSUE) 67 (1996) (arguing that state competition would lead to significant failures in environmental law if the federal government were to repeal its standards).

2 See DAVID VOGEL, *TRADING UP: CONSUMER AND ENVIRONMENTAL REGULATION IN A GLOBAL ECONOMY* 259 (1995) (arguing that competition among states may lead to a “ratch-

camp views federalism as creating a powerful incentive for states to engage in harmful and inefficient deregulation. According to this line of thought, state legislatures desire to attract corporations to their jurisdictions in order to increase tax revenues, create jobs, and generally improve their economies. But in order to appeal to the corporations and corporate executives that make decisions about where to locate business, states must adopt regulations that are *more permissive* than the regulations in force in other states. As each state adopts progressively looser regulations in order to outdo their neighbors, the resulting degradation of standards leads to suboptimal levels of regulation, whether it be in shareholder protections,³ labor laws,⁴ tax levels,⁵ or environmental standards.⁶

The race-to-the-top camp sees things differently. According to this model of federalism, competition between states on regulatory structures in fact leads to better, more efficient levels of regulation.⁷ While the precise dynamics of this process differ depending on the issue area, the basic argument is that if the market is functioning correctly, corporations should benefit from *better* regulation, not from the absence of it. After all, corporations have constituencies as well, and if their shareholders are regularly fleeced by corporate management or their employees live in polluted cities, they will eventually lobby for change (or go elsewhere). As a result, states have incentives to provide regulations that promote overall prosperity, rather than favoring the narrow interests of the few. Over time, then, states should pro-

eting upward of regulatory standards in competing political jurisdictions"); Jonathan H. Adler, *Interstate Competition and the Race to the Top*, 35 HARV. J.L. & PUB. POL'Y 89, 89 (2012) (arguing that "robust interjurisdictional competition facilitates the enactment of better public policy at the state level"); Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210, 1212 (1992) (arguing that competition among states on environmental regulations leads to an efficient allocation of industrial activity); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977) (arguing that state competition on corporate law tends toward optimal regulation).

3 See Cary, *supra* note 1; Schwartz, *supra* note 1, at 555–56.

4 See *United States v. Darby*, 312 U.S. 100, 115 (1941) ("The motive and purpose of [federal labor laws] are plainly to make effective the Congressional conception of public policy that interstate commerce should not be made the instrument of competition in the distribution of goods produced under substandard labor conditions, which competition is injurious to the commerce and to the states from and to which the commerce flows.").

5 See Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 380 (1996) (arguing that the "accelerating use of state tax incentives to attract and retain businesses . . . is costly and unproductive" but that "each state finds it difficult to walk away from the competition as long as other states continue to up the ante").

6 See Swire, *supra* note 1.

7 There is a sharp divide within the race-to-the-top scholarship on whether the "top" that is being raced to is *optimal* regulation or rather *stricter* regulation. For examples of the former, see Winter, *supra* note 2, at 254; and Revesz, *supra* note 2, at 1214. For examples of the latter, see VOGEL, *supra* note 2; and Anu Bradford, *The Brussels Effect*, 107 Nw. U. L. REV. 1, 5 (2012).

gressively improve the quality and efficiency of their regulatory structures in order to outcompete their neighboring states.

Despite their disagreements, however, both the race-to-the-bottom and race-to-the-top theories share one fundamental assumption—that states race to *distinguish* their laws from the laws of other states.⁸ In other words, for there to be a race upward or downward, states must seek to outdo one another, either by steadily loosening their regulations or steadily tightening them. Both theories take for granted that this dynamic will lead to ever more extreme regulatory structures.

But the assumption that interstate competition leads inevitably to differentiation overlooks another powerful aspect of interstate competition that in many ways counteracts the races to the top and bottom. This dynamic, which may usefully be called the “race to the middle,” pushes states toward regulatory schemes that are similar or identical to the schemes adopted by sufficiently large numbers of other states. The race to the middle encourages states to focus on harmonizing, not differentiating, their regulatory structures.

The race to the middle is driven by four interrelated factors, all of which provide benefits to states from adopting well-established regulatory structures already prevailing in other states. First, states that adopt regulatory structures already existing in other states benefit from informational effects about the benefits and risks of the structure. Second, the prevalence of an already-established regulatory structure provides greater familiarity and, thus, certainty to corporations and other regulated actors about the effects of the regulation on their activities, thereby increasing the attractiveness of jurisdictions that adopt that structure. Third, states benefit from network effects when they adopt regulatory structures that are interoperable with the regulatory structures in place in other states. And finally, states that adopt well-established regulatory structures that are common across the nation are less likely to face regulatory intervention from federal lawmakers.

In many ways, the race to the middle is a reassuring phenomenon. It suggests that regulatory competition does not inevitably lead to ever more extreme forms of regulation. It counteracts countervailing pressures for states to race to the bottom by deregulating at the expense of consumers and citizens or overregulating to the detriment of beneficial corporate activity. And it works to reduce the magnitude and prevalence of conflicting laws that can raise the cost of doing business across borders.

But the race to the middle is not without costs. In fact, it raises a number of new and underappreciated concerns about the nature of federalism and its effects on state competition. First, in a kind of elevated “tyranny of the majority” problem, the race to the middle may allow suboptimal, but widely adopted, regulatory schemes to crowd out more efficient, but sparsely adopted, ones. Second, the race to the middle may reduce policy innovation

8 See, e.g., RICHARD A. POSNER & KENNETH E. SCOTT, *ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION* 111 (1980) (arguing that states differentiate their regulatory regimes in order to appeal to particular constituencies).

as states seek to engage in copycat regulation rather than acting as laboratories of democracy. Third, the race to the middle reduces the ability of individuals and companies to “vote with their feet” by leaving one jurisdiction and moving to another.

This Article proceeds in three parts. Part I examines the scholarly literature on regulatory competition and describes the conventional wisdom regarding races to the bottom and races to the top. Part II sets forth an alternative dynamic by which regulatory competition may lead to races to the middle where states seek to adopt regulatory schemes that are consistent with, or even identical to, the schemes already present in other jurisdictions. Part III concludes by outlining a set of implications of, and potential concerns regarding, races to the middle.

I. THE RACES TO THE EXTREMES

Federalist principles underlie much of our constitutional system.⁹ While the precise contours of where the national government’s powers end and state governments’ powers begin are the subject of vociferous debate,¹⁰ it is indisputable that states have broad discretion to set their own laws and regulations in a variety of policy areas.¹¹ This decentralized system is widely understood to promote a set of values essential to our democracy, from protecting autonomy to promoting popular sovereignty to encouraging policy experimentation.¹² One important consequence of federalist principles, however, is that state laws interact with each other, sometimes in unexpected ways.¹³ Low taxes in one state may attract corporations away from states with higher taxes, but better public services may push individuals in the opposite

9 See Akhil Reed Amar, *Of Sovereignty and Federalism*, 96 YALE L.J. 1425, 1426 (1987); Heather K. Gerken, *Foreword: Federalism All the Way Down*, 124 HARV. L. REV. 4, 6 (2010); Martin H. Redish & Karen L. Drizin, *Constitutional Federalism and Judicial Review: The Role of Textual Analysis*, 62 N.Y.U. L. REV. 1 (1987). But see John F. Manning, *Federalism and the Generality Problem in Constitutional Interpretation*, 122 HARV. L. REV. 2003 (2009).

10 See, e.g., DANIEL J. ELAZAR, *AMERICAN FEDERALISM: A VIEW FROM THE STATES* 162 (2d ed. 1972); MORTON GRODZINS, *THE AMERICAN SYSTEM: A NEW VIEW OF GOVERNMENT IN THE UNITED STATES* (Daniel J. Elazar ed., 1966); John Kincaid, *The Competitive Challenge to Cooperative Federalism: A Theory of Federal Democracy*, in *COMPETITION AMONG STATES AND LOCAL GOVERNMENTS* 87, 87–88 (Daphne A. Kenyon & John Kincaid eds., 1991); Larry D. Kramer, *Putting the Politics Back into the Political Safeguards of Federalism*, 100 COLUM. L. REV. 215 (2000); Saikrishna B. Prakash & John C. Yoo, *The Puzzling Persistence of Process-Based Federalism Theories*, 79 TEX. L. REV. 1459 (2001); Susan Rose-Ackerman, *Cooperative Federalism and Co-optation*, 92 YALE L.J. 1344 (1983).

11 See Lea Brilmayer & Ronald D. Lee, *State Sovereignty and the Two Faces of Federalism: A Comparative Study of Federal Jurisdiction and the Conflict of Laws*, 60 NOTRE DAME L. REV. 833, 833 (1985).

12 See Amar, *supra* note 9, at 1428.

13 See Adler, *supra* note 2, at 89; Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 685 (2002); Mark J. Roe, *Delaware’s Competition*, 117 HARV. L. REV. 588, 591 (2003); Mark J. Roe, *Delaware’s Politics*, 118 HARV. L. REV. 2491, 2493 (2005).

direction.¹⁴ Strong labor protections in one state may push corporations to relocate to states with weaker protections, but better employment opportunities may push individuals in the opposite direction.¹⁵ These interactions create opportunities for competition between states, as local legislatures seek to attract individuals and companies to their jurisdictions.¹⁶

The ultimate result of this regulatory competition is uncertain. On the one hand, it may lead to a race to the bottom, in which states eliminate beneficial (but costly) regulation in order to attract businesses to their states.¹⁷ On the other hand, it may lead to a race to the top, in which states attempt to improve their regulations in an effort to create an environment that efficiently balances the interests of all relevant actors.¹⁸ These opposing dynamics, which may be referred to as “races to the extremes,” both suggest that states are engaged in a long-term competition to distinguish themselves from other states by offering different and ever more extreme regulatory schemes in order to “outcompete” their neighbors. This Part will describe federalism’s role in promoting regulatory competition among states, outline competing models for how this regulatory competition unfolds, and set out a few initial thoughts on why these models are flawed.

A. Federalism and Regulatory Competition

Federalism is a bedrock principle of our constitutional system.¹⁹ It permeates debates about law, civics, and ideology, and scholars continue to discuss its proper role in the American political system.²⁰ At its core, however, it embodies a simple principle: the national government is a government of limited powers, with important powers reserved for the province of the

14 See Robert S. Chirinko & Daniel J. Wilson, *Tax Competition Among U.S. States: Racing to the Bottom or Riding on a Seesaw?* (Fed. Reserve Bank of S.F., Working Paper No. 2008-03, 2017), <http://www.frbf.org/economic-research/files/wp08-03bk.pdf> (arguing that state tax levels fluctuate strategically based on changing out-of-state tax policy, preferences for government services, and economic and demographic conditions).

15 See Ronald B. Davies & Krishna Chaitanya Vadlamannati, *A Race to the Bottom in Labor Standards? An Empirical Investigation*, 103 J. DEV. ECON. 1, 1 (2013); Timothy P. Glynn, *Interjurisdictional Competition in Enforcing Noncompetition Agreements: Regulatory Risk Management and the Race to the Bottom*, 65 WASH. & LEE L. REV. 1381, 1382 (2008); Steven L. Willborn, *Labor Law and the Race to the Bottom*, 65 MERCER L. REV. 369, 369 (2014).

16 See Mark J. Roe, *Regulatory Competition in Making Corporate Law in the United States—And Its Limits*, 21 OXFORD REV. ECON. POL’Y 232, 232–33 (2005).

17 See *supra* note 1.

18 See *supra* note 2.

19 See *supra* note 9.

20 See, e.g., Jessica Bulman-Pozen, *Partisan Federalism*, 127 HARV. L. REV. 1077 (2014) (arguing that partisanship explains why states check the federal government and why citizens identify with states as well as the nation); Heather K. Gerken, *Slipping the Bonds of Federalism*, 128 HARV. L. REV. 85, 85 (2014) (describing three views of federalism, respectively, comic, heroic, and tragic); Abbe R. Gluck, *Our [National] Federalism*, 123 YALE L.J. 1996 (2014); Cristina M. Rodríguez, *Negotiating Conflict Through Federalism: Institutional and Popular Perspectives*, 123 YALE L.J. 2094 (2014) (arguing that federalism’s core value is its creation of a framework for negotiating disagreement).

states.²¹ This idea, that governmental authority must be shared between the national government, on the one hand, and state governments, on the other, has given rise to the peculiarly American system of decentralization in which states have significant decisional power over broad swathes of regulatory policy.²²

The principle of federalism is often justified by reference to a set of values core to the ideals of democratic governance.²³ Federalism is said to promote *choice* by allowing states to adopt the policies that most closely align with the beliefs of their citizens and allowing citizens to move between the states.²⁴ It is said to encourage *experimentation* by allowing states to adopt new and innovative policies to address the problems facing their citizens.²⁵ It is said to protect citizens from *tyranny* by diffusing power among the several states and preventing the national government from consolidating ever greater powers.²⁶ And it is said to foster civic *education* by encouraging citizens to participate more directly in the process of self-governance.²⁷ All of

21 See, e.g., Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485, 1494 (1994).

22 These reserved powers extend to the so-called “police powers,” related to the health, safety, and morals of citizens, but the precise outlines of state authority are the subject of fierce debate. See Randy E. Barnett, *The Proper Scope of the Police Power*, 79 NOTRE DAME L. REV. 429, 429 (2004) (“When it comes to the power of states over their people, the issue has always been shrouded in doubt.”).

23 See Akhil Reed Amar, *Five Views of Federalism: “Converse-1983” in Context*, 47 VAND. L. REV. 1229 (1994) (arguing that theories of federalism can be categorized into nationalistic, laboratory, political-market, political-safeguards, and double-source-of-protection perspectives); Michael W. McConnell, *Federalism: Evaluating the Founders’ Design*, 54 U. CHI. L. REV. 1484, 1493–1511 (1987) (book review).

24 See, e.g., Kramer, *supra* note 10, at 222.

25 Of course, the canonical statement here is Justice Brandeis’s dissent in *New State Ice Co. v. Liebmann*, in which he states that “[i]t is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.” *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting); see also *Fed. Energy Regulatory Comm’n v. Mississippi*, 456 U.S. 742, 788–89 (1982) (O’Connor, J., concurring in the judgment in part and dissenting in part) (“[T]he 50 States serve as laboratories for the development of new social, economic, and political ideas. This state innovation is no judicial myth.” (footnote omitted)); Amar, *supra* note 23, at 1233–36 (critically evaluating the perspective of states as laboratories of democracy); McConnell, *supra* note 23, at 1498–1500 (analyzing the economic arguments behind state innovation).

26 This effect of the federal system was famously remarked upon by de Tocqueville, who wrote:

It is incontestably true that the love and the habits of republican government in the United States were engendered in the townships and in the provincial assemblies. . . . [I]t is this same republican spirit, it is these manners and customs of a free people, which are engendered and nurtured in the different States, to be afterwards applied to the country at large.

1 ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 181 (Henry Reeve trans., London, Longman, Green, Longman & Roberts 1862) (1835).

27 See DAVID L. SHAPIRO, *FEDERALISM: A DIALOGUE* 92–94 (1995).

these values—choice, experimentation, protection from tyranny, and education—are thought to be advanced by our system of federalism.²⁸

Of course, the result of federalism is that states maintain substantial freedom to choose laws that differ from the laws of their neighbors, or, for that matter, from the laws of the national government. Colorado, for example, was free to decriminalize recreational marijuana use in 2013, despite the fact that such use was prohibited in other states and, indeed, under national law.²⁹ California, similarly, was free to establish a cap-and-trade system for greenhouse gas emissions in 2012 in order to combat global warming, despite the notable lack of such a scheme at the national level.³⁰ And Illinois was free in 2015 to pass legislation regulating the use of police body cameras to reduce police abuse, despite the failure of other states to do the same.³¹

One important corollary to this principle of differentiation in state law is that states are free to compete with one another through their legislation as well. If one state offers a set of employee-friendly employment rules (say, generous maternity leave) that ends up drawing citizens to their state, other states may decide to enact even more employee-friendly rules (say, generous maternity *and* paternity leave) in order to outdo the other state. If one state offers generous business incentives (say, low corporate income taxes) that end up drawing corporations to their state, other states may decide to enact even more generous business incentives (say, no corporate income taxes) in order to win those corporations back to their own states. In other words, federalism potentially leads to regulatory competition among the states.³²

Regulatory competition, of course, is not a free-for-all. There are important limitations on the bounds of this competition, limitations imposed by the Constitution, federal law, and political realities. The Supremacy Clause of the Constitution, which provides that national law trumps state law, prevents states from competing in such a way that would conflict with Congressional action.³³ Preemption doctrine goes even further, preventing states from acting at all in any area over which Congress has occupied the regula-

28 See Gerken, *supra* note 9, at 12.

29 This development was certainly not without controversy. See Erwin Chemerinsky et al., *Cooperative Federalism and Marijuana Regulation*, 62 UCLA L. REV. 74, 77 (2015) (arguing that “[t]he struggle over marijuana regulation is one of the most important federalism conflicts in a generation”).

30 See David Sloss, *California’s Climate Diplomacy and Dormant Preemption*, 56 WASHBURN L.J. 507, 511–13 (2017) (describing the history and effects of California’s cap-and-trade system).

31 See Mary D. Fan, *Privacy, Public Disclosure, Police Body Cameras: Policy Splits*, 68 ALA. L. REV. 395, 413–19 (2016) (discussing the divergent state laws on the use of police body cameras).

32 See Francesco Parisi et al., *Two Dimensions of Regulatory Competition*, 26 INT’L REV. L. & ECON. 56 (2006).

33 See Barry Friedman, *Valuing Federalism*, 82 MINN. L. REV. 317, 342–43 (1997) (discussing the effects of the Supremacy Clause on federalism).

tory field.³⁴ The Dormant Commerce Clause prohibits states from competing in such a way that discriminates against interstate commerce or places an excessive burden on commerce.³⁵ And the fact that states must interact with one another in the House of Representatives and the Senate in order to protect their interests imposes significant pressures on states to not overstep the norms of proper regulatory competition.³⁶

The presence of regulatory competition as a structural feature of federalism has deep consequences for our system of democratic governance. States are free—within limits, of course—to enact policies that favor themselves and disfavor, or even harm, others. They need not establish rules that mirror or harmonize with the laws of other states. And they have substantial leeway to respond to legislative enactments in other states with regulations of their own. The consequences of this competition on the quality and substance of law are thus matters of supreme importance. They are also, perhaps understandably, the subject of substantial debate.

B. *The Race to the Bottom*

A prominent group of scholars has argued that federalism leads to a race to the bottom in state law.³⁷ By the race to the bottom, these scholars generally mean that states enact progressively less efficient or desirable legal regimes as a result of regulatory competition.³⁸ For example, in the corporate law context, it is often used to refer to the adoption of management-friendly and shareholder-hostile regulations.³⁹ In the environmental law context, it often means lowering pollution-control standards.⁴⁰ And in the taxation context, it often refers to the reduction of tax rates.⁴¹ In each of these contexts, the term has a negative connotation—that is, that regulatory competition will lead to *excessively* management-friendly corporate laws, *excessively* lax environmental laws, and *excessively* low tax rates.

34 See Caleb Nelson, *Preemption*, 86 VA. L. REV. 225 (2000) (analyzing modern preemption doctrine and the interaction between federal and state law).

35 See Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1092 (1986) (arguing that the Supreme Court's jurisprudence on the Dormant Commerce Clause is motivated exclusively by the desire to prevent states from engaging in "purposeful economic protectionism").

36 Although it is unclear to what extent these norms of behavior remain a significant limiting principle on state action. See Cynthia R. Farina, *Congressional Polarization: Terminal Constitutional Dysfunction?*, 115 COLUM. L. REV. 1689 (2015). But see Jacob E. Gersen & Eric A. Posner, *Soft Law: Lessons from Congressional Practice*, 61 STAN. L. REV. 573 (2008).

37 See *supra* note 1.

38 *Id.*

39 See Cary, *supra* note 1, at 685–86.

40 See Robert L. Glicksman & Richard E. Levy, *A Collective Action Perspective on Ceiling Preemption by Federal Environmental Regulation: The Case of Global Climate Change*, 102 NW. U. L. REV. 579, 597–98 (2008).

41 See Roger J. Vaughan, *State Taxation and Economic Development*, in STATE TAXATION POLICY 3, 78 (Michael Barker ed., 1983).

Why would state legislatures adopt inefficient laws? One explanation, of course, would be that they simply do not know the full effects of their laws, or perhaps they are simply incompetent at drafting them.⁴² But, importantly, race-to-the-bottom scholars typically do not assume that legislators are irrational. Instead, they argue that their very rationality, and their pursuit of their own states' interests, obliges them to adopt suboptimal laws.⁴³ Racing to the bottom is a rational choice.

The race to the bottom is rational because states compete for the business of corporations.⁴⁴ They of course compete for a number of things, but race-to-the-bottom scholars typically focus on the scarce resource of *corporate presence*.⁴⁵ This can mean both formal incorporations with their respective secretaries of state and less formal activities (such as the setting up of offices, manufacturing of goods, or selling of products in a state).⁴⁶ In each of these cases, corporate presence confers benefits to the state—in the form of fees, taxes, employment, wages, and other matters.⁴⁷ States have an interest in maximizing these goods, as they contribute to the overall welfare of their populations, and thus they rationally seek to attract corporate presence.

But, paradoxically, states' rational pursuit of corporate business ultimately ends up harming them.⁴⁸ The primary tool that states use to attract corporations to their jurisdictions is regulatory structure.⁴⁹ In particular,

42 This is not certainly not an implausible premise. See Adam J. Hirsch, *Cognitive Jurisprudence*, 76 S. CAL. L. REV. 1331 (2003) (describing the various forms of bounded rationality that affect lawmakers).

43 See, e.g., Blake Hudson, *Commerce in the Commons: A Unified Theory of Natural Capital Regulation Under the Commerce Clause*, 35 HARV. ENVTL. L. REV. 375, 401 (2011) (describing the rationality of state governments in engaging in a race-to-the-bottom in environmental regulation).

44 See Alvin K. Klevorick, *The Race to the Bottom in a Federal System: Lessons from the World of Trade Policy*, 14 YALE L. & POL'Y REV. (SYMP. ISSUE) 177, 178 (1996) ("At the heart of this race to the bottom argument is the view that the competitive process among countries is imperfect.").

45 See Daniel J.H. Greenwood, *Democracy and Delaware: The Mysterious Race to the Bottom/Top*, 23 YALE L. & POL'Y REV. 381, 384 (2005) ("Each state has an incentive to entice out-of-state corporations to incorporate under its law because it derives tax revenue from the corporation.").

46 Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 233–40 (1985) (describing the dynamic of competition for incorporations).

47 See Roe, *Delaware's Competition*, *supra* note 13, at 590 ("States, or at least some of them, are said to use their corporate law to compete for corporate tax revenue and ancillary benefits . . ."); Romano, *supra* note 46, at 228 (describing the assumption of race-to-the-bottom theories that the "objective of states is revenue maximization").

48 See Hudson, *supra* note 43, at 380–85 (analogizing the race-to-the-bottom dynamic to the individually rational, but collectively destructive, tragedy of the commons).

49 See William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 GEO. L.J. 201, 268 (1997); Daniel B. Rodriguez, *Turning Federalism Inside Out: Intrastate Aspects of Interstate Regulatory Competition*, 14 YALE L. & POL'Y REV. (SYMP. ISSUE) 149, 156 (1996). But see Romano, *supra* note 46, at 226–27 ("[F]rom a firm's perspective, the benefit of a Delaware domicile, which, in part, flows from Delaware's volume of incorporations, is not just the guarantee of

states compete with other states by offering laws that are *more corporation friendly*⁵⁰ than the laws found in other states.⁵¹ This may mean that they adopt environmental laws that are less strict than the environmental laws found in other states, or labor protections that are more permissive, thereby reducing the costs for corporations of doing business in their states. And while corporation-friendly laws are not per se undesirable, they may become so if they end up crowding out other policy goals that are of equal or greater value to citizens.

Race-to-the-bottom scholars argue that this is precisely what happens in practice. Each state has a similar interest in attracting corporations to their own jurisdictions and away from others, thereby creating a regulatory race, as states constantly seek to reduce regulatory costs for corporations by creating regulatory schemes that are ever laxer.⁵² The end result of this race is an undesirable level of deregulation across a number of issue areas. Thus, perfectly rational state competition can lead to mutually destructive regulatory outcomes.

The race-to-the-bottom dynamic, of course, has slightly different connotations depending on the issue area, and it is perhaps worthwhile to highlight a few variations on the concept. These variations, while not calling into question the fundamental underpinnings of the race-to-the-bottom dynamic, serve to demonstrate the variety of factors that influence the decision-making processes of states.

One of the most well-known races to the bottom is found in corporate law.⁵³ The corporate law race begins with the observation that ownership of

being located in a state that is responsive to corporate desires but also access to a legal system that reduces uncertainty concerning the consequences of actions and hence the transaction costs of doing business.”).

50 Of course, what counts as “corporation friendly” is a bit ambiguous. Corporations, after all, are made up of a number of different constituencies, and what benefits one of these constituencies may not benefit all of them. One prominent conflict is that between shareholders and managers, but other conflicts exist as well—between employees and shareholders, between directors and employees, between customers and shareholders. This distinction can be important in determining the direction and content of the race to the bottom, as will be described further below.

51 See Franz Xaver Perrez, *The Efficiency of Cooperation: A Functional Analysis of Sovereignty*, 15 ARIZ. J. INT’L & COMP. L. 515, 543 (1998) (noting that “by adopting a ‘corporation-friendly’ regulatory regime, Delaware has become the leading U.S. state of incorporation”).

52 See Swire, *supra* note 1, at 70–71 (arguing that the race to the bottom, as it is often used, should more appropriately be considered a “Race to Laxity”).

53 Given the importance that corporate law has played in the development of the race-to-the-bottom literature, it should perhaps be unsurprising that the field has a number of proponents and critics, many of whom propose slightly different versions of how the race functions (or does not function) in practice. See Robert Anderson IV, *The Delaware Trap: An Empirical Analysis of Incorporation Decisions*, 91 S. CAL. L. REV. 657, 700–01 (2018) (arguing that factors unrelated to the quality of state law strongly drive incorporation decisions); Robert Anderson IV & Jeffrey Manns, *The Delaware Delusion*, 93 N.C. L. REV. 1049, 1049 (2015) (arguing that “lawyers . . . engag[e] in default decision making based on Delaware’s

a company is separate from control of the company.⁵⁴ Shareholders delegate the day-to-day operations of their corporations to professional managers, and those managers are tasked with running the company for the benefit of the shareholders.⁵⁵ This organizational structure, while offering important benefits, creates a conflict at the heart of corporate law: managers who make decisions for corporations may seek to run the corporation for their own benefit, rather than for the benefit of all shareholders. Race-to-the-bottom scholars argue that states seek to take advantage of this conflict by appealing, not to the overall interests of corporations, but rather to the individual managers that make decisions on behalf of the corporation.⁵⁶ These corporate managers are themselves rational decisionmakers and, thus, should be expected to maximize their own interests when making decisions on behalf of the corporation.⁵⁷ One important factor for corporate managers in deciding where to incorporate (or reincorporate) is the level of protection offered by a state's regulations.⁵⁸ All else equal, a manager should prefer a state that offers greater protections for managers—from, for example, fiduciary duty lawsuits or hostile takeovers—than a state that offers fewer protections.⁵⁹ States, recognizing the importance of this factor in management decision-making, compete to adopt regulatory structures that are ever more skewed in

past preeminence, rather than actively weighing" the substantive value of Delaware law); Bebchuk, *supra* note 1, at 1440 (arguing that state charter competition leads to a race to the bottom on some corporate law issues, but a race to the top on others); Cary, *supra* note 1, at 666 (arguing that state charter competition leads to a "race for the bottom" in corporate law); John F. Coyle, *Business Courts and Interstate Competition*, 53 WM. & MARY L. REV. 1915, 1934 (2012) (arguing that the proliferation of state business courts cannot be justified under theories of interstate competition); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 919–20 (1982) (arguing that state charter competition has led to a "climb to the top" rather than a race to the bottom); Kahan & Kamar, *supra* note 13, at 684 (arguing that there is no race at all because Delaware has a monopoly on corporate law).

54 See ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 3–5 (1932).

55 *Id.*

56 Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CALIF. L. REV. 1775, 1780 (2002); Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1170 (1999). Indeed, corporate franchise taxes can make up a substantial portion of a state's budget. In 2016, Delaware's franchise taxes, entity fees, and corporate income taxes raised \$1.21 billion, accounting for an astounding thirty-one percent of the state's net budgetary revenue. See STATE OF DEL., *GENERAL OBLIGATION BONDS, SERIES 2017*, at 46 (2017), http://finance.delaware.gov/investorinfo/Series_2017_POS.pdf.

57 See Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 469–70 (1987) (examining the role of managerial interests in contributing to Delaware's corporate law).

58 See *id.* at 471 ("The principal area in which these inefficiencies [in corporate law rules] can be expected to occur is that of rules protecting incumbent managers against the threat of hostile takeovers.").

59 *Id.* at 485.

favor of incumbent management.⁶⁰ This dynamic is problematic (and thus a race to the *bottom*) because it ignores the interests of shareholders.⁶¹ By adopting excessively management-friendly laws, states deprive shareholders of the rights and privileges that, in the absence of competition, a more efficient regulatory structure would grant.⁶²

While the corporate law race to the bottom focuses primarily on the conflict between interest groups internal to corporations,⁶³ the race to the bottom in environmental law focuses on the conflict between internal and external groups.⁶⁴ It is well recognized that many basic environmental goods, such as clean air, pure water, and healthy ecosystems, are true public goods—in other words, they are nonrivalrous and nonexcludible, and one actor's efforts to preserve and protect them provides benefits that accrue to all other actors.⁶⁵ But just as the benefits of environmental protection accrue to all, so too do the harms from environmental degradation.⁶⁶ If an actor emits carbon in one jurisdiction that contributes to global warming, that harm will affect not just the actor that causes the harm, and not just the jurisdiction in which the carbon is released, but also actors and individuals around the globe.⁶⁷ Thus, polluting actors do not bear the full cost of their actions, a result that can lead to excessive activity in pollution-causing industries.⁶⁸ A potential solution to this problem would be to regulate environmental harms so that actors are prevented from engaging in actions that are inefficient from a collective perspective, or, similarly, to impose the full cost

60 See Bebchuk et al., *supra* note 56, at 1779 (“[S]tate competition induces states to provide rules that managers, but not necessarily shareholders, favor with respect to corporate law issues that significantly affect managers’ private benefits of control, such as rules governing takeovers.”); Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the “Race” Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1872 (2002) (concluding that “managers generally migrate to (and fail to migrate away from) the typical state antitakeover statutes”).

61 See Bebchuk, *supra* note 1, at 1458–84 (analyzing the ways in which the demand for management-friendly law may lead state competition that reduces shareholder value).

62 *Id.* at 1483–84.

63 It should be noted that the corporate law race to the bottom has not always focused solely on the conflict between management and ownership. Indeed, it has at times included externalities as an important mechanism enabling the race to the bottom. See *id.* at 1485–95. What is more, the conflict between ownership and management could potentially be analyzed under an externalities framework. But the problems are sufficiently idiosyncratic that it may be helpful here to review them separately.

64 See Kirsten H. Engel, *State Environmental Standard-Setting: Is There a “Race” and Is It “to the Bottom”?*, 48 HASTINGS L.J. 271, 304–05 (1997); Daniel C. Esty, *Revitalizing Environmental Federalism*, 95 MICH. L. REV. 570, 627 (1996); Joshua D. Sarnoff, *The Continuing Imperative (but Only from a National Perspective) for Federal Environmental Protection*, 7 DUKE ENVTL. L. & POL’Y F. 225, 283 (1997); Swire, *supra* note 1, at 70.

65 See Matthew J. Kotchen, *Public Goods*, in ENVIRONMENTAL AND NATURAL RESOURCE ECONOMICS: AN ENCYCLOPEDIA 271, 271–73 (Timothy C. Haab & John C. Whitehead eds., 2014); James Salzman, *Valuing Ecosystem Services*, 24 ECOLOGY L.Q. 887, 893 (1997).

66 See Esty, *supra* note 64, at 575–84.

67 *Id.* at 583–84.

68 See Daniel B. Kelly, *Strategic Spillovers*, 111 COLUM. L. REV. 1641, 1644 (2011).

of an activity's harm on the actor creating it.⁶⁹ But states, who have substantial freedom to set their own environmental policies and standards, have reasons to refrain from regulating their own corporations at mutually efficient levels. After all, if they impose fewer regulatory costs on their own corporations, their corporations will have an advantage over corporations located in jurisdictions with higher environmental standards.⁷⁰ Adding to the problem, states have an interest in adopting looser environmental regulations than their neighboring states in order to attract corporations to incorporate in their own jurisdictions.⁷¹ The result is that states race to adopt excessively permissive environmental rules that ultimately harm their constituents.⁷²

The race to the bottom, thus, focuses heavily on federalism's capacity to generate inefficiencies. In the corporate law context, the inefficiency derives from the conflict of interest between management and ownership in the corporate structure. In the environmental law context, the inefficiency derives from the problem of environmental externalities, where actors do not bear the full cost of the harms that they create. But in each case, state competition through regulation leads to inefficient rules that create a number of

69 See *id.* at 1694–1703.

70 See William Magnuson, *International Corporate Bribery and Unilateral Enforcement*, 51 COLUM. J. TRANSNAT'L L. 360, 373–74 (2013); William Magnuson, *Unilateral Corporate Regulation*, 17 CHI. J. INT'L L. 521, 530–31 (2017).

71 Some scholars have argued that the race to the bottom in environmental law should be analyzed separately from the problem of externalities. See, e.g., Glicksman & Levy, *supra* note 40, at 606; Revesz, *supra* note 2, at 1212.

72 Another mechanism contributing to the race to the bottom in environmental law is the dispersed nature of the harm from environmental degradation and the concentrated nature of the benefits. A firm that is operating in a carbon-intensive industry (presumably) receives substantial benefits from engaging in the relevant activity, but the harms from the release of carbon are spread across a large number of actors—indeed, the victims may well include the entire population of the globe. The cost of organizing large numbers of dispersed actors is high, and thus local politicians may not feel strong pressure to protect citizens (and noncitizens) from environmental harms. The beneficiaries of the activity, on the other hand, are concentrated and are more likely to have economic interests to lobby against environmental regulations that impose costs on their businesses. See Esty, *supra* note 64, at 597–98 (“Notably, the costs of environmental regulation are generally more concentrated and tangible than the benefits. Costs are often borne by particular industries or enterprises, and are translated readily into monetary terms. Benefits, however, accrue to the general public in ways that are hard to discern and monetize.” (footnote omitted)); Scott R. Saleska & Kirsten H. Engel, “Facts Are Stubborn Things”: An Empirical Reality Check in the Theoretical Debate over the Race-to-the-Bottom in State Environmental Standard-Setting, 8 CORNELL J.L. & PUB. POL'Y 55, 64 (1998) (“According to the economic theory of regulation, laws tend to respond to the wants of small, cohesive special interest groups, such as industry, at the expense of the wants of the larger, more diffuse public. The public, which is the intended beneficiary of stringent regulation, is often in a weaker political position than industry, which is the primary beneficiary of less regulation.” (footnote omitted)); see also Jonathan H. Adler, *Free & Green: A New Approach to Environmental Protection*, 24 HARV. J.L. & PUB. POL'Y 653, 665–66 (2001); Todd J. Zywicki, *Environmental Externalities and Political Externalities: The Political Economy of Environmental Regulation and Reform*, 73 TUL. L. REV. 845, 918–20 (1999).

pathologies in a federalist system. In seeking to win favor with corporations by adopting ever looser regulatory structures that distinguish themselves from other jurisdictions, states engage in an ultimately self-destructive drive toward extreme deregulation. Thus, in the views of race-to-the-bottom scholars, federalism tends to lower the quality of state law.

C. *The Race to the Top*

While race-to-the-bottom scholars argue that federalism encourages states to engage in destructive competition that leads to inefficient law, race-to-the-top scholars argue the opposite—that it leads states toward better regulatory structures.⁷³ Rather than forcing states to eliminate efficient regulation, competition creates strong incentives for states to adopt regulations that balance the interests of all actors, thereby leading to more efficient social outcomes. Under race-to-the-top theories of constitutional structure, then, federalism spurs regulatory efficiency by increasing the benefits of marginal improvements in state law.

Just like the race to the bottom, the race-to-the-top dynamic begins with the assumption that states seek to attract corporations to their states. But while the race-to-the-bottom dynamic focuses on the presence of market failures (such as conflicts of interest or externalities), the race-to-the-top dynamic focuses on the power of market efficiencies.⁷⁴ Well-functioning markets, after all, should lead to efficient allocations of resources.⁷⁵ In the absence of disabling externalities or some other noncorrectable market failure, both consumers *and* suppliers of a product should gain from competition.⁷⁶

The race-to-the-top literature argues that markets for regulation work similarly to markets for any other type of good. Corporations benefit, not from the absence of regulation, but rather from *good* regulation.⁷⁷ If a food company relocates to a jurisdiction that has no health and safety codes, it might reduce its short-term costs, but it also sends a powerful signal to consumers about the quality of the company's products. If a technology company moves to a jurisdiction that provides for no liability for data breaches, it

73 As mentioned above, the term “race to the top” is also at times used to describe the phenomenon of state competition leading to *stricter* regulation, rather than more efficient regulation. See, e.g., VOGEL, *supra* note 2, at 258–59; Bradford, *supra* note 7, at 5. While this Section will focus primarily on the literature on the race to efficiency, it will also briefly discuss the dynamics of this alternative view of races to the top.

74 See Winter, *supra* note 2, at 260.

75 Joseph E. Stiglitz, *The Allocation Role of the Stock Market: Pareto Optimality and Competition*, 36 J. FIN. 235, 235 (1981).

76 *Id.*

77 See Frank H. Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540, 571 (1984); Fischel, *supra* note 53, at 919–20; Winter, *supra* note 2, at 256; see also Summer Kim, *Corporate Long Arms*, 50 ARIZ. ST. L.J. 1067, 1108 (2018) (arguing that corporate long-arm statutes can be used to overcome the dynamics that push states toward a race to the bottom).

might reduce its exposure to lawsuits, but it would also provide users with important information about the company's priorities. Thus, while the race-to-the-bottom dynamic assumes that regulatory competition between states will inevitably lead to excessive deregulation because of the pathologies of corporate decisionmaking, the race-to-the-top dynamic argues that these pathologies are less powerful than many believe.⁷⁸ As a result, in a truly competitive market, efficient regulation will tend to attract corporations more than lack of regulation. States, recognizing this fact, attempt to distinguish themselves by providing ever more effective regulatory regimes.⁷⁹

Take, for example, the case of corporate law. Race-to-the-top scholars argue that the race-to-the-bottom theory fundamentally misunderstands how corporate decisionmaking works.⁸⁰ While it may be true that corporate managers prefer in the abstract to locate their corporations in jurisdictions that provide high levels of protection for incumbent managers, shareholders do not share this preference.⁸¹ If a corporation reincorporates into an excessively management-friendly jurisdiction, shareholders will rationally view this decision as indicative of the corporation's risks and benefits.⁸² Corporations based in excessively management-friendly jurisdictions will find it more difficult to raise money in the capital markets (at least from shareholders), their stock prices may decline, and they may become more vulnerable to takeover attempts.⁸³ Thus, corporations should not systematically demand more management-friendly corporate laws from states. Instead, they should seek states with strong, well-designed shareholder-protection regimes.⁸⁴ These jurisdictions will be able to provide greater certainty to investors about their rights and privileges, and thus should allow corporations to have a competitive advantage in the capital markets.⁸⁵ Indeed, it has long been recognized that one way that corporations can improve their reputations with investors and lenders is to "bond" themselves to jurisdictions with strong corporate-governance standards.⁸⁶ This has been a standard explanation for why interna-

78 Winter, *supra* note 2, at 256–58.

79 *Id.* at 256.

80 See Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259, 260–61 (1980); Easterbrook, *supra* note 77, at 549–50; Fischel, *supra* note 53, at 920–21; Winter, *supra* note 2, at 256.

81 See Fischel, *supra* note 53, at 918–19.

82 *Id.* at 919–20.

83 *Id.* at 919.

84 *Id.* at 919–20.

85 *Id.*

86 See John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1830 (2002) [hereinafter Coffee, *Racing Towards the Top?*] ("Cross-listing may in part be . . . a bonding mechanism to assure public investors that they will not be exploited . . ."); John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 691–92 (1999) [hereinafter Coffee, *The Future as History*] ("The simplest explanation for the migration of foreign issuers to U.S. exchanges and NASDAQ is that such a listing is a form of bonding . . .").

tional corporations often list their stock on U.S. stock exchanges—by doing so, they signal to the international capital markets that they are committed to running their businesses properly.⁸⁷ Concomitantly, states benefit from high corporate law standards that provide strong protections for shareholders and prevent management overreaching. Regulatory competition in corporate law, then, is driven by states constantly seeking to distinguish themselves from other states through ever more effective shareholder-protection rules.

Similarly, race-to-the-top scholars argue that federalism creates incentives for states to improve their environmental regulations. While critics of environmental federalism worry that states will lower environmental standards in order to give their corporations a competitive advantage, race-to-the-top theorists argue that environmental problems are often best dealt with at the local level. Local governments are more attuned to the desires of their voters, they have better knowledge about the kinds of environmental problems that affect their regions, and they are more willing to experiment to discover new solutions to old environmental problems.⁸⁸ Far from being unwilling to address environmental issues, state governments actively seek to enact laws that reflect the environmental preferences of their constituents. After all, while a corporation may have a strict firm-level preference for lower environmental regulations, to the extent that the corporation's employees or shareholders are located within a state, their preferences may override the firm-level preference. Indeed, it is not uncommon for state-level environmental protections to be *more* stringent than national-level protections,⁸⁹ not less, a fact that race-to-the-top theorists view as strong evidence that environmental federalism does not lead to a race to the bottom.⁹⁰ The mechanisms driving this development include legislative responsiveness to the environmental concerns of their constituents, general state interests in improving the state's national reputation, and a more economically driven desire to give

87 Coffee, *Racing Towards the Top?*, *supra* note 86; Coffee, *The Future as History*, *supra* note 86.

88 See ALEXANDER VOLOKH ET AL., REASON PUB. POLICY INST. & NAT'L ENVTL. POLICY INST., RACE TO THE TOP: THE INNOVATIVE FACE OF STATE ENVIRONMENTAL MANAGEMENT (1998); Adler, *supra* note 2, at 89; Jonathan H. Adler, *When Is Two a Crowd? The Impact of Federal Action on State Environmental Regulation*, 31 HARV. ENVTL. L. REV. 67, 108–14 (2007); Revesz, *supra* note 2, at 1212; Wallace E. Oates, *On Environmental Federalism*, 83 VA. L. REV. 1321, 1322 (1997) (“Competition among governments, like competition in the private sector, embodies incentives that point public officials in the right direction.”).

89 See, e.g., Brady Dennis & Juliet Eilperin, *States Aren't Waiting for the Trump Administration on Environmental Protections*, WASH. POST (May 19, 2019), https://www.washingtonpost.com/national/health-science/states-arent-waiting-for-the-trump-administration-on-environmental-protections/2019/05/19/5dc853fc-7722-11e9-b3f5-5673edf2d127_story.html.

90 But see Revesz, *supra* note 2, at 1229 (arguing that the “proliferation of more stringent state [environmental] standards is not necessarily inconsistent with the race to the bottom”).

in-state corporations an early-adopter advantage in future environmental schemes and regulations.⁹¹

Regardless of the particular mechanisms driving regulatory competition, race-to-the-top scholars agree that federalism should be expected to lead to better law. By giving both corporations and citizens options about where to locate, federalism forces states to compete for their loyalties. They do so by improving the quality of their laws and regulations in order to create the conditions for thriving local communities, businesses, and governments.

II. THE RACE TO THE MIDDLE

The race to the top and the race to the bottom provide starkly different visions of federalism as a constitutional doctrine. Race-to-the-bottom scholars argue that federalism leads states to adopt inefficient regulatory structures in order to appeal to powerful interest groups.⁹² Race-to-the-top scholars, on the other hand, hold that federalism leads states to progressively improve their regulatory structures in order to create better conditions for their citizens.⁹³ Despite the substantial conflict between the conclusions that these two theories reach, however, both models of federalism share a basic assumption—that federalism leads states to *differentiate* themselves from other states. In the race-to-the-bottom model of federalism, states seek to make their corporate laws *more management friendly* or their environmental laws *less burdensome* than the relevant laws in other jurisdictions. In the race-to-the-top model of federalism, states seek to make their corporate laws *better balanced* or their environmental laws *more attuned* to the interests of their citizens than the relevant laws in other jurisdictions. In other words, both the race-to-the-bottom and race-to-the-top theories posit that regulatory competition leads to increasingly extreme (in the case of the race to the bottom, extremely inefficient; in the case of the race to the top, extremely efficient) regulatory schemes.

But, as this Part will argue, states often have interests that push them in a different direction—to the middle. Rather than differentiating their regulatory structures from other states, states often seek to assimilate their laws to the laws of other jurisdictions. This race to the middle pushes states to adopt laws that are similar or identical to the laws in place in a sufficiently large number of other jurisdictions. They do so in response to the informational benefits that accrue to states that adopt well-established legal regimes, the demand by constituents for familiar regulatory regimes, the network effects that are generated from interoperable regulatory structures, and the reduced

91 See VOGEL, *supra* note 2, at 259; J.R. DeShazo & Jody Freeman, *Timing and Form of Federal Regulation: The Case of Climate Change*, 155 U. PA. L. REV. 1499, 1519 (2007); Kirsten H. Engel & Barak Y. Orbach, *Micro-Motives and State and Local Climate Change Initiatives*, 2 HARV. L. & POL'Y REV. 119, 134 (2008); Lesley K. McAllister, *Regional Climate Regulation: From State Competition to State Collaboration*, 1 SAN DIEGO J. CLIMATE & ENERGY L. 81, 87 (2009).

92 See *supra* note 38 and accompanying text.

93 See *supra* note 73 and accompanying text.

risk of federal intervention that arises when states adopt mainstream regulatory structures. These powerful state interests are underappreciated by the “race-to-the-extreme” theories of regulatory competition that are prevalent today.

The presence of a race-to-the-middle dynamic in state competition does not, however, eliminate the possibility that states will race to the extremes in other issue areas. The race to the middle is dependent on a set of specific conditions that will not be present in all circumstances. This Part will outline these conditions and conclude by suggesting that the race to the middle provides a strong counterdynamic to race-to-the-top and race-to-the-bottom models of federalism.

A. *The Benefits of the Middle*

Under a race-to-the-middle dynamic, states seek to adopt regulatory structures that are similar or identical to the regulatory structures already in place in a substantial portion of other states. As opposed to the race to the top and the race to the bottom, which tend to drive overall regulatory quality toward ever greater levels of efficiency or inefficiency, the primary effect of the race to the middle is to reduce the overall variation in the quality and content of substantive law. This Section will argue that states have strong interests in adopting laws that mirror those in place in other states, irrespective of the independent desirability of those laws. In particular, racing to the middle offers four primary benefits to states. First, states benefit from a number of informational effects when they adopt legal regimes that are well established and widely prevalent. Second, corporations and firms have strong interests in seeking out, and locating themselves in, jurisdictions that have familiar legal structures. Third, adopting a widely prevalent legal structure provides a set of interoperability benefits for both corporations and firms. And fourth, the risk of federal intervention is lower when states have legal structures well within the norms of other state behavior.

1. Informational Effects

States adopt laws for many reasons, but one of the most important ones is to guide and constrain the behavior of their citizens.⁹⁴ They pass laws out-

94 See, e.g., RONALD DWORKIN, *LAW'S EMPIRE* 148 (1986) (recognizing the pragmatist view that laws should generally be enforced in accordance with their plain meaning because “[o]therwise government would lose its power to control people’s behavior, and this would obviously make the community as a whole worse off”); H.L.A. HART, *THE CONCEPT OF LAW* 116 (3d ed. 2012) (“There are therefore two minimum conditions necessary and sufficient for the existence of a legal system. On the one hand, those rules of behaviour which are valid according to the system’s ultimate criteria of validity must be generally obeyed, and, on the other hand, its rules of recognition specifying the criteria of legal validity and its rules of change and adjudication must be effectively accepted as common public standards of official behaviour by its officials.”); Joseph Raz, *The Identity of Legal Systems*, 59 CALIF. L. REV. 795, 802 (1971), *reprinted in* JOSEPH RAZ, *THE AUTHORITY OF LAW: ESSAYS ON LAW AND MORALITY* 78, 86 (2d ed. 2009) (“Laws guide human behaviour, help

lawing murder because they want to deter their citizens from killing one another and to punish those who do. They pass laws outlawing drunk driving because they want to stop their citizens from endangering others and to remove those who do from the streets. But of course, states face substantial uncertainty about whether their laws will in fact change behaviors in the way they desire.⁹⁵ Laws protecting disabled workers from being fired may lead to employers refusing to hire them in the first place.⁹⁶ Laws protecting the habitats of endangered species may lead to landowners destroying those habitats before the endangered species arrive.⁹⁷ Uncertainty about the effects of regulation on behavior can be costly for states because it may lead them to enact ineffective laws or delay beneficial regulation.

States that adopt a race-to-the-middle strategy can reduce these uncertainties by enacting laws that other states have already adopted. By doing so, they gain significant information on how their chosen legal structures work, or at least how they work in other places.⁹⁸ This benefit of the “middle” strategy, while perhaps obvious, should not be underestimated.⁹⁹ Legislation creates a number of risks and uncertainties for states. The statute may contain errors or oversights that undermine the purposes of its drafters.¹⁰⁰ Judges may fail to interpret the law in a way that legislators expect.¹⁰¹ Private parties may respond to the law in unpredictable ways.¹⁰² By adopting legisla-

people in planning and deciding on their future course of action, and provide standards for evaluating past or planned actions.”).

95 See Cass R. Sunstein, *Political Equality and Unintended Consequences*, 94 COLUM. L. REV. 1390, 1390 (1994) (“It is a familiar point that government regulation that is amply justified in principle may go terribly wrong in practice.”).

96 See Daron Acemoglu & Joshua D. Angrist, *Consequences of Employment Protection? The Case of the Americans with Disabilities Act*, 109 J. POL. ECON. 915, 917 (2001).

97 See Dean Lueck & Jeffrey A. Michael, *Preemptive Habitat Destruction Under the Endangered Species Act*, 46 J.L. & ECON. 27, 27 (2003).

98 See, e.g., ALAN WATSON, *LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW* (2d ed. 1993); William Ewald, *Comparative Jurisprudence (II): The Logic of Legal Transplants*, 43 AM. J. COMP. L. 489 (1995); Vlad Perju, *Constitutional Transplants, Borrowing, and Migrations*, in THE OXFORD HANDBOOK OF COMPARATIVE CONSTITUTIONAL LAW 1305 (Michel Rosenfeld & András Sajó eds., 2012).

99 Of course, the fact that many other states have adopted the legal regime in question might also send a signal to other states about the quality of that law. See Robert J. Shiller, *Conversation, Information, and Herd Behavior*, 85 AM. ECON. REV. 181 (1995) (examining how herd behavior may result from information discovery by others). Thus, the very existence of a middle might suggest that the middle is (relatively) efficient—after all, a significant number of other states decided to adopt the structure and stay with it. But this conclusion is questionable for a number of reasons, as further explored in Part III.

100 For a discussion of the effect of legislative errors, see Ryan D. Doerfler, *The Scrivener’s Error*, 110 NW. U. L. REV. 811 (2016).

101 See, e.g., John F. Manning, *The Absurdity Doctrine*, 116 HARV. L. REV. 2387 (2003); Cass R. Sunstein, *Interpreting Statutes in the Regulatory State*, 103 HARV. L. REV. 405 (1989).

102 See, e.g., Samuel Issacharaoff & George Loewenstein, *Unintended Consequences of Mandatory Disclosure*, 73 TEX. L. REV. 753, 753 (1995) (arguing that legislation aimed at “mandatory disclosure will have the opposite of its intended effect”); Sunstein, *supra* note 95, at 1391.

tion that is closely correlated with preexisting and prevalent legislation elsewhere, states can minimize the risks of unintended consequences.

One important informational benefit of shifting to the middle is the ability to learn from past mistakes. The learning benefits of legislation can be large. For example, when states were considering minimum-wage laws in the last few decades, one important question was whether instituting a state minimum wage would reduce employment.¹⁰³ Economic theory has long suggested that it would, based on simple rules of supply and demand—as the price of labor increases, demand for it should decrease.¹⁰⁴ But after several states adopted higher minimum-wage laws, studies found that the rules did not lead to a decrease in employment, at least when the increase was not excessive.¹⁰⁵ These results provided important information to other states about the effects of minimum-wage laws and thus allowed them to make more informed decisions when deciding whether to adopt similar laws.

The informational benefits of the “middle” are consistent with the substantial economic literature demonstrating a second-mover advantage in certain markets.¹⁰⁶ The fundamental insight of this literature is that, while it is sometimes beneficial to be the first company or firm to innovate (the “first-mover advantage”), it is often even better to allow one’s competitors to innovate and then enter the market afterward (the “second-mover advantage”).¹⁰⁷ Innovating is costly and risky, as it requires substantial research

103 For a summary of the debate, see David Neumark & William Wascher, *Minimum Wages and Low-Wage Workers: How Well Does Reality Match the Rhetoric?*, 92 MINN. L. REV. 1296 (2008).

104 See Mark G. Kelman, *Progressive Vacuums*, 48 STAN. L. REV. 975, 981 (1996) (book review) (“Mainstream economists are, with very few exceptions, quite hostile to minimum wage laws.”); John M. Peterson, *Employment Effects of Minimum Wages, 1938–50*, 65 J. POL. ECON. 412, 413 (1957) (“The competitive model of the firm, which assumes a horizontal labor-supply curve and a smoothly declining labor-demand curve, implies that an imposed wage increase, other things remaining the same, will reduce employment and reduce it more, the larger the wage increase.”); George J. Stigler, *The Economics of Minimum Wage Legislation*, 36 AM. ECON. REV. 358, 361 (1946) (“[T]he net effects of the minimum wage on aggregate employment are adverse.”).

105 See David Card, *Do Minimum Wages Reduce Employment? A Case Study of California, 1987–89*, 46 INDUS. & LAB. REL. REV. 38, 38 (1992); David Card & Alan B. Krueger, *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania*, 84 AM. ECON. REV. 772, 792 (1994); Lawrence F. Katz & Alan B. Krueger, *The Effect of the Minimum Wage on the Fast Food Industry*, 46 INDUS. & LAB. REL. REV. 6, 6 (1992). But see David Neumark, *The Effects of Minimum Wages on Employment*, FED. RES. BANK S.F. (Dec. 21, 2015), <https://www.frbsf.org/economic-research/publications/economic-letter/2015/december/effects-of-minimum-wage-on-employment/> (summarizing the results of numerous minimum-wage studies and concluding that the evidence is “conflicting”).

106 See, e.g., STEVEN P. SCHNAARS, *MANAGING IMITATION STRATEGIES* 29–30 (1994); Joseph Farrell & Garth Saloner, *Standardization, Compatibility, and Innovation*, 16 RAND J. ECON. 70, 75–79 (1985); Brett M. Frischmann & Mark A. Lemley, *Essay, Spillovers*, 107 COLUM. L. REV. 257, 268–70 (2007).

107 See Michael Kopel & Clemens Löffler, *Commitment, First-Mover, and Second-Mover Advantage*, 94 J. ECON. 143 (2008); Fernando Suarez & Gianvito Lanzolla, *The Half-Truth of First-Mover Advantage*, HARV. BUS. REV., Apr. 2005, at 121.

and effort *ex ante* and it is unclear whether sufficient demand *ex post* will offset the upfront costs.¹⁰⁸ Furthermore, if other actors can enter the market at lower costs after the first mover has created the product and proven the viability of the strategy, the “second movers” may have an advantage over the first movers because they have avoided the substantial upfront costs.¹⁰⁹

Similarly, states that are seeking to reform their laws have the option of attempting to innovate (that is, create new rules or laws that have little precedent) or copy (that is, adopt the rules or laws that other states have adopted). The benefit of being a second mover here is that states avoid the cost of surveying citizens to identify voter preferences, contacting companies to determine the effects of the new law on business, and otherwise researching the innumerable effects of new regulatory schemes. Instead, they have a simple and reliable model that has been proven and tested in other states. Indeed, the second-mover advantage is likely even stronger in the regulatory sphere than in private markets, given that the precise structure of a given regulatory scheme—that is, its legislative text—is publicly available, while the production methods for new products tend to be privately held trade secrets that are closely guarded.¹¹⁰

Thus, one important benefit to states of shifting regulation to the middle, rather than the bottom or the top, is that doing so provides a set of valuable informational benefits to the legislating state.¹¹¹ It reduces uncertainty by allowing the state to observe the effects of the chosen regulatory structure in other circumstances. It prevents legislative mistakes by allowing the state to exploit the learning benefits of other states. And it minimizes transaction costs by allowing the state to take advantage of well-established structures that have already been tested by other states. Thus, from the supply-side perspective of regulation, racing to the middle creates a set of benefits for the states that decide to adopt the strategy.

108 See F.M. SCHERER, *NEW PERSPECTIVES ON ECONOMIC GROWTH AND TECHNOLOGICAL INNOVATION* 53–88 (1999); Ian Ayres, *Supply-Side Inefficiencies in Corporate Charter Competition: Lessons from Patents, Yachting and Bluebooks*, 43 U. KAN. L. REV. 541, 545 (1995) (arguing that since “[i]ndividual states have a reduced incentive to solve problems of corporate governance because successful statutory solutions may be quickly copied by rival jurisdictions . . . , even if state legislatures are engaged in a race-to-the-top with respect to the creation of corporate law, there are strong theoretical reasons to expect that the race will not proceed at an efficiently fast pace”); Benjamin N. Roin, *Intellectual Property Versus Prizes: Reframing the Debate*, 81 U. CHI. L. REV. 999, 1018 (2014).

109 See F. Scott Kieff, *Property Rights and Property Rules for Commercializing Inventions*, 85 MINN. L. REV. 697, 708–09 (2001).

110 See *id.*

111 But see Hannah J. Wiseman, *Regulatory Islands*, 89 N.Y.U. L. REV. 1661, 1672 (2014) (arguing that an “information deficit” at the state level both “limits the experimental upside of laboratories—the efficient, effective, and innovative approaches that can emerge from experimentation—and expands the known downside of federalism: the costs to private actors of identifying and ensuring compliance with fifty or more different standards”).

2. Familiarity

But if the race to the middle only provided benefits to the *suppliers* of law (that is, legislatures), and failed to provide clear benefits to the *consumers* of that law (that is, citizens, firms, corporations, and other groups), it is unclear that the race to the middle could overcome the countervailing pressures of interest groups. After all, even the most pessimistic theories of regulatory competition assume that legislatures are responsive to the interests and desires of *some* of their constituents, even if they do not accurately represent the interests of society more broadly. Thus, it is not enough that state legislators benefit from racing to the middle—for the race to the middle to prove enduring, it must also provide benefits to constituents. For simplicity's sake, this subsection will focus on the interests of firms and companies generally, as this is the group at the center of most theories of regulatory competition, but it is worth noting that many of these arguments apply with equal vigor to ordinary individuals as well.

One important benefit to corporations of operating within a state that has adopted a “middle” regulatory structure is that the operative structure is familiar to them.¹¹² Corporations, and corporate executives acting on their behalf, seek to avoid uncertain regulatory environments.¹¹³ Uncertain or vague laws make for bad business environments, environments where beneficial transactions are more costly due to the lack of certainty over the legal treatment of transactions.¹¹⁴ In order to avoid these costs, corporations have an interest in seeking out familiar regulatory structures, and the race to the middle helps provide these to them.

There are strong rational choice reasons that underlie this preference for familiarity. A number of studies have shown, for example, that when firms face uncertain regulatory environments, they will take otherwise inefficient actions in order to offset this uncertainty.¹¹⁵ For example, they tend to

112 See Brian J. Broughman & Darian M. Ibrahim, *Delaware's Familiarity*, 52 SAN DIEGO L. REV. 273, 276 (2015) (arguing that “while Delaware may have begun its ascent to the top of the corporate law hierarchy by offering more desirable law than its leading competitor, it stays there as much because it is *familiar* to business parties as for its substantive virtues” (footnote omitted)); Jill E. Fisch & Steven Davidoff Solomon, Centros, *California's “Women on Board” Statute and the Scope of Regulatory Competition*, 20 EUR. BUS. ORG. L. REV. 493 (2019) (arguing that the internal affairs doctrine has led to less variation in corporate law than in Europe); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 736 (1987) (“One factor that transaction cost economics emphasizes is that reducing uncertainty reduces the cost of doing business.”).

113 See Anna Gelpern et al., *If Boilerplate Could Talk: The Work of Standard Terms in Sovereign Bond Contracts*, 44 LAW & SOC. INQUIRY 617 (2019) (describing the preferences of sovereign bond markets for “market standard” terms in contracts); Romano, *supra* note 46, at 274 (“These features of stability and predictability are desired by managers who need quick opinions on proposed activities.”).

114 See Romano, *supra* note 46, at 275.

115 See, e.g., THOMAS TRAUTMANN, ENVIRONMENTAL INVESTMENT DECISIONS UNDER REGULATORY UNCERTAINTY: AN ANALYSIS OF CORPORATE RESPONSES TO REGULATORY UNCERTAINTY IN THE EUROPEAN EMISSION TRADING SCHEME (2007); Philip H. Birnbaum, *The Choice of*

postpone large strategic decisions.¹¹⁶ They tend to decrease their investments in long-term projects.¹¹⁷ And they tend to reduce risky expenditures on research and development into new products.¹¹⁸ What is more, regulatory uncertainty is particularly pronounced when new rules are in the process of being formulated and enacted.¹¹⁹ All of these considerations suggest that corporations will, all else equal, prefer jurisdictions with familiar legal regimes over ones with unfamiliar regimes.

But in addition to rational economic reasons for preferring familiar, “middle” regulatory structures, there are also behavioral biases that contribute to the preference. For example, studies have repeatedly shown that individual decisionmaking is skewed by the so-called “endowment effect,” under which individuals value the items they currently possess more highly than the items they do not possess.¹²⁰ The endowment effect makes it less likely that individuals will be willing to abandon current arrangements in favor of other, rationally more beneficial arrangements. Similarly, individuals suffer from “status quo biases,” under which they strongly prefer to maintain their current state of affairs rather than change to alternative ones.¹²¹ The status quo bias has been demonstrated to have substantial effects on important financial decisions, including health plans and retirement programs.¹²² Finally, when individuals are faced complex problems, they tend to resort to heuristics to resolve them.¹²³ Rather than attempt to maximize their interests, they

Strategic Alternatives Under Increasing Regulation in High Technology Companies, 27 ACAD. MGMT. J. 489 (1984); David L. Levy, *Business and International Environmental Treaties: Ozone Depletion and Climate Change*, CAL. MGMT. REV., Spring 1997, at 54.

116 See Christian Engau & Volker H. Hoffman, *Strategizing in an Unpredictable Climate: Exploring Corporate Strategies to Cope with Regulatory Uncertainty*, 44 LONG RANGE PLAN. 42, 44 (2011).

117 See Ben S. Bernanke, *Irreversibility, Uncertainty, and Cyclical Investment*, 98 Q.J. ECON. 85, 85 (1983) (concluding that “[i]n an environment in which the underlying stochastic structure is itself subject to random change, events whose long-run implications are uncertain can create an investment cycle by temporarily increasing the returns to waiting for information”); George Bittlingmayer, *Regulatory Uncertainty and Investment: Evidence from Antitrust Enforcement*, 20 CATO J. 295, 295–96 (2001); Nick Bloom et al., *Uncertainty and Investment Dynamics*, 74 REV. ECON. STUD. 391, 391 (2007); Alex Cukierman, *The Effects of Uncertainty on Investment Under Risk Neutrality with Endogenous Information*, 88 J. POL. ECON. 462, 462 (1980).

118 See Birnbaum, *supra* note 115, at 496.

119 Barbara Farnham, *Impact of the Political Context on Foreign Policy Decision-Making*, 25 POL. PSYCHOL. 441, 454 (2004); David P. McCaffrey, *Corporate Resources and Regulatory Pressures: Toward Explaining a Discrepancy*, 27 ADMIN. SCI. Q. 398, 404 (1982).

120 See Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1325 (1990); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1107–13 (2000).

121 See Daniel Kahneman et al., *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, J. ECON. PERSP., Winter 1991, at 193, 194; William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7, 7–8 (1988).

122 See Samuelson & Zeckhauser, *supra* note 121, at 7.

123 See Korobkin & Ulen, *supra* note 120, at 1075–1102.

instead tend to “satisfice,” that is, opt for the most readily available choice that is sufficiently beneficial to meet their basic requirements.¹²⁴ Satisficing, of course, may not be fully irrational if the cost of acquiring the additional information necessary to make a maximizing decision is prohibitive, but it does suggest that corporate managers will favor familiar regulatory structures that have worked before.¹²⁵ All of these biases suggest that, even if there are sound reasons for corporations to prefer new regimes that offer benefits over older ones, corporations may still opt for more familiar regimes out of irrational behavioral biases.

This preference for familiarity in the corporate context is aptly demonstrated by a now-famous puzzle of start-up and venture capitalist strategy. When venture capitalists invest in start-ups, they generally demand that the start-up become a “C corporation,” a particular kind of corporation that imposes a double-taxation penalty on investors, with the firm paying taxes on its income once at an entity level and then the investors paying tax again when the profits are distributed to them.¹²⁶ This decision is normally justified by a combination of arguments related to tax-exempt investors, initial public offering rules, and the ability to offer stock options.¹²⁷ But in recent years, a number of tax scholars have demonstrated that there is a more favorable tax structure for start-ups that meets these basic requirements and also prevents double taxation—the limited liability company, or LLC.¹²⁸ Several studies have demonstrated that venture capitalists, by utilizing the more favorable research and development deductions of LLCs, could increase returns to investors by over five percent.¹²⁹ Despite the seemingly overwhelming evidence in favor of this new structure, however, the C-corporation structure continues to predominate.¹³⁰ One important reason, many theorists suggest, is that the C-corporation structure is now so familiar to practitioners, including the lawyers and investors that draft and execute investment documents, that they are psychologically and professionally committed to the structure despite potential benefits of other structures.¹³¹

124 See HERBERT A. SIMON, *ADMINISTRATIVE BEHAVIOR*, at xxix (3d ed. 1976) (“Whereas economic man maximizes—selects the best alternative from among all those available to him, his cousin, administrative man, satisfices—looks for a course of action that is satisfactory or ‘good enough.’”); Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 215 (1995).

125 See George J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213, 213 (1961).

126 See Calvin H. Johnson, *Why Do Venture Capital Funds Burn Research and Development Deductions?*, 29 VA. TAX REV. 29 (2009); Eric J. Allen et al., *On the Tax Efficiency of Startup Firms* (May 2018) (unpublished manuscript), <https://ssrn.com/abstract=3069256>.

127 See Johnson, *supra* note 126, at 31–34.

128 See Allen et al., *supra* note 126, at 1.

129 See *id.* at 2.

130 *Id.* at 1.

131 The cost of switching to a new structure is, of course, not just psychological. The cost of drafting new form documents, analyzing the legal validity of these documents, and reaching agreement with stakeholders on the proper content of the documents could be

Finally, familiarity also provides benefits to third parties. When a company is considering doing business with another company, it needs to know, at least in general terms, how the other company operates.¹³² For example, it will want to know that its executive has authority to enter into contracts, that its limited-liability rules are the same, and that it is subject to the same types of bankruptcy rules.¹³³ But if the other company is subject to an entirely different legal regime, the costs of doing business with it rise exponentially.¹³⁴ How can the out-of-state company be assured that the company will meet its obligations? It would need to do substantial research on the state law or hire a local lawyer to delve into the differences. If instead, the state has adopted wholesale the majority law for these areas, then the out-of-state company can be reasonably assured that it knows the rules of the road.

All of this is not to suggest that corporations have no interest in the substance and content of laws—they certainly do. It is also not to suggest that corporate executives are unconcerned with the laws that govern them—they certainly are.¹³⁵ But rather it is to suggest that one important component of law, and one that corporations and corporate executives care deeply about, is familiarity. All else equal, corporations and their decisionmakers prefer regulatory structures that resemble the regulatory structures they have dealt with in other jurisdictions. This preference is deeply rooted, through internal and external causes, and creates a strong reason for corporations to gravitate toward middle jurisdictions, as opposed to bottom or top jurisdictions that have new or different laws. The question then becomes how much weight corporations give to familiarity as an independent value of law, as opposed to the weight they give to other features of law.

3. Interoperability

While states benefit from the greater informational effects of middle regulatory structures, and corporations benefit from the greater familiarity of those structures, both groups benefit from another important feature of the middle: greater interoperability. In many cases, legal structures grow increas-

high. But again, this suggests even more potently the strong forces pushing corporations and other commercial entities toward the familiar, middle regulatory structure.

132 See generally LOU R. KLING & EILEEN NUGENT SIMON, *NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS* § 8.02, Lexis (database updated June 2019) (discussing the typical due-diligence requirements in an acquisition).

133 *Id.*

134 See Gilles Cuniberti, *Is the CISG Benefiting Anybody?*, 39 VAND. J. TRANSNAT'L L. 1511, 1513–17 (2006).

135 In some cases, these interests may well override any interest in familiarity. See, e.g., Ronald J. Gilson & David M. Schizer, *Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock*, 116 HARV. L. REV. 874, 881 (2003) (“[T]he power of standardization should not be overstated, since parties [can and] will depart from market practice when a departure is profitable enough to overcome the information costs they will incur.”).

ingly effective and efficient as more jurisdictions adopt them.¹³⁶ The interoperability effect of regulation can create strong pressures for states to adopt laws that resemble those of their neighbors.

Interoperability generally refers to the ability of two rules or systems to interact seamlessly with one another.¹³⁷ Take the paradigmatic example of train tracks.¹³⁸ If one state adopts a law that all train tracks must be of a certain size or “gauge,” and a neighboring state adopts a law requiring train tracks to be of a different gauge, the result will be a system with low interoperability, one that is rife with transaction costs: trains will not be able to run across state lines, goods that cross borders will need to be unloaded and reloaded onto different trains, and train travel will be significantly more expensive and time consuming.¹³⁹ But if the two states adopt the same law, requiring train tracks to be of the same gauge, both sides will benefit: the dead weight loss of transaction costs is eliminated and both sides should receive the advantage of seamless travel from one state to the other, regardless of the relative distribution of train companies, shippers, and travelers in the two states.

Interoperability effects provide a strong reason for states to adopt laws similar to those of their neighbors. Regardless of whether states prefer laxer or stricter regulations, they have a separate and independent interest in eliminating wasteful or burdensome regulation.¹⁴⁰ This interest is mirrored by the interest of corporations in standardization and the elimination of bureaucratic costs.¹⁴¹ Indeed, corporations have a long history of lobbying governments to adopt more standardized regulations among themselves.¹⁴² In recent years, the financial technology industry has pressed states to streamline their conflicting regulations on financial technology licenses, and in

136 There is a large literature describing the benefits (and costs) of standardization in markets. See, e.g., Paul A. David, *Clio and the Economics of QWERTY*, 75 AM. ECON. REV. 332, 335 (1985); Farrell & Saloner, *supra* note 106, at 70–71; Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CALIF. L. REV. 479, 516 (1998).

137 See Aaron K. Perzanowski, *Rethinking Anticircumvention’s Interoperability Policy*, 42 U.C. DAVIS L. REV. 1549, 1554–57 (2009).

138 See generally Douglas J. Puffert, *The Standardization of Track Gauge on North American Railways, 1830–1890*, 60 J. ECON. HIST. 933 (2000); Daniel P. Gross, *The Ties That Bind: Railroad Gauge Standards, Collusion, and Internal Trade in the 19th Century U.S.* (Harvard Bus. Sch., Working Paper No. 17-044, 2016).

139 This was in fact the case in the United States in the early 1800s. Although railroad gauges were not regulated by states, individual railways chose the gauge that they would use on their own railroads, and this led to a wide variety in the standards and sizes of rails. See Puffert, *supra* note 138, at 933. The lack of standardization became such a problem that a term was developed for it: “breaks of gauge” referred to the common problem of two railroads of different gauge meeting. *Id.*

140 But see Einer R. Elhauge, *Does Interest Group Theory Justify More Intrusive Judicial Review?*, 101 YALE L.J. 31, 35–44 (1991) (describing the interest group theory of politics).

141 See, e.g., Magnuson, *Unilateral Corporate Regulation*, *supra* note 70, at 551–52.

142 See, e.g., Eric Lipton & Danny Hakim, *Lobbying Bonanza as Firms Try to Influence European Union*, N.Y. TIMES (Oct. 18, 2013), <https://www.nytimes.com/2013/10/19/world/europe/lobbying-bonanza-as-firms-try-to-influence-european-union.html>.

2018, a group of seven state banking regulators announced that they would cooperate to harmonize their processes.¹⁴³ Rideshare companies like Uber and Lyft have lobbied state legislatures to pass comprehensive transport regulation that would eliminate the patchwork of conflicting regulations in place in different jurisdictions.¹⁴⁴ Corporations have lobbied state governments to adopt more harmonized labor laws governing their treatment of workers in order to avoid the cost of enacting different internal policies in different states.¹⁴⁵ And of course, one of the most successful state harmonization efforts, and one that was widely supported by business, was the Uniform Commercial Code, which has now been adopted by all states in one form or another, and which harmonizes state rules governing commercial transactions.¹⁴⁶

The interoperability of regulations has particular importance in areas where markets naturally or necessarily have interjurisdictional reach. One prominent example of this is the energy market, and in particular, the renewable energy market. Because the sources of renewable energy (solar, wind, and others) are available in different amounts at different times in different states, it is generally efficient for companies to both harvest and sell energy across borders.¹⁴⁷ But if every state adopted different substantive requirements for energy provision in its own jurisdiction, the ability of companies to operate across states would be severely impaired. States, recognizing this, have rushed to adopt startlingly similar renewable energy regulations. In particular, they have coalesced around a program known as a “renewable portfolio standard,” which requires electric utilities to produce a certain percentage of their electricity from renewable energy sources.¹⁴⁸ Thirty-nine states have

143 See Lalita Clozel, *Seven States Team Up on Fintech Licenses*, WALL ST. J. (Feb. 6, 2018), <https://www.wsj.com/articles/seven-states-team-up-on-fintech-licenses-1517923800>.

144 See Liam Dillon, *Bill Would Let Uber, Lyft Drivers Get a Single California Business License Rather than Multiple Local Ones*, L.A. TIMES (Aug. 2, 2017), <https://www.latimes.com/politics/la-pol-ca-uber-license-fees-20170802-story.html>; Ken Lovett, *Uber, Lyft Spent Nearly \$1M on NYS Lobbying So Far in 2016*, N.Y. DAILY NEWS (Aug. 8, 2016), <https://www.nydailynews.com/news/politics/uber-lyft-spent-1m-nys-lobbying-2016-article-1.2741680>; Kimberly Reeves, *As Texas Lawmakers Consider Statewide Ridesharing Rules, Lobbying Efforts Go into Overdrive*, AUSTIN BUS. J. (Mar. 15, 2017), <https://www.bizjournals.com/austin/news/2017/03/15/as-texas-lawmakers-consider-statewide-ridesharing.html>.

145 See Walter Kolvenbach, *EEC Company Law Harmonization and Worker Participation*, 11 U. PA. J. INT’L BUS. L. 709, 709 (1990).

146 See Robert Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 798 (1958); Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Law Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83, 84 (1993); *Uniform Commercial Code (UCC)*, DUKE U. SCH. L., <https://web.law.duke.edu/lib/researchguides/ucc/> (last updated Dec. 2016).

147 See generally PAUL W. PARFOMAK ET AL., CONG. RESEARCH SERV., R44747, *CROSS-BORDER ENERGY TRADE IN NORTH AMERICA: PRESENT AND POTENTIAL* (2017).

148 See Joshua P. Fershee, *Moving Power Forward: Creating a Forward-Looking Energy Policy Based on a National RPS*, 42 CONN. L. REV. 1405, 1414 (2010); Felix Mormann, *Clean Energy Federalism*, 67 FLA. L. REV. 1621, 1621, 1624–25 (2015); Jim Rossi, *The Limits of a National Renewable Portfolio Standard*, 42 CONN. L. REV. 1425, 1428–29 (2010).

now adopted renewable portfolio standards, a remarkable level of uniformity, given that twenty-five years ago, only two states had them.¹⁴⁹

Importantly, both the race to the top and the race to the bottom greatly reduce the potential for interoperability benefits among states. If states consistently seek to distinguish themselves by enacting ever stricter or laxer rules, businesses will struggle to operate seamlessly across borders. Different or varying standards in state law raise the cost of business for corporations that operate in interjurisdictional markets. The race to the middle, on the other hand, helps obviate these problems.

Interoperability effects are only strengthened when they overlap with network effects.¹⁵⁰ Network effects, also sometimes referred to as network externalities, are the benefits that accrue to consumers as more consumers adopt the product.¹⁵¹ A classic example is the telephone: if only one consumer owns a phone, it is not particularly valuable, but if many consumers own it, its value increases exponentially. A more modern example is offered by social media networks such as Facebook or Twitter, in which consumers of the product value the product more highly as additional consumers enter the market.

Regulations, just like products, often benefit from network effects. Certain regulations grow in value as they are more widely adopted by other jurisdictions, largely because of the positive externalities of each adoption. Once a regulation has reached a certain level of acceptance, it becomes very unlikely that states will adopt other, incompatible regulations. This is so because the network effects of the widely accepted regulatory structure can easily swamp any other potential benefits of the regulation. This phenomenon is often referred to as path dependence—today's decisions or arrangements are strongly influenced by initial decisions or arrangements.¹⁵² While

149 See *State Renewable Portfolio Standards and Goals*, NAT'L CONF. ST. LEGISLATURES (Oct. 1, 2019), <http://www.ncsl.org/research/energy/renewable-portfolio-standards.aspx>. It is perhaps worth noting that some scholars have viewed the proliferation of renewable portfolio standards among the states as an example of the race to the top. See, e.g., Barry Rabe, *Race to the Top: The Expanding Role of U.S. State Renewable Portfolio Standards*, SUSTAINABLE DEV. L. & POL'Y, Spring 2007, at 10, 11. The argument here is that over time states have steadily increased the proportion of energy that must be generated from renewable sources. McAllister, *supra* note 91, at 86; Rabe, *supra*, at 12. But later studies have questioned these empirical conclusions. See Lincoln L. Davies, *State Renewable Portfolio Standards: Is There a "Race" and Is It "to the Top"?*, 3 SAN DIEGO J. CLIMATE & ENERGY L. 3, 49–77 (2012).

150 See Philip H. Dybvig & Chester S. Spatt, *Adoption Externalities as Public Goods*, 20 J. PUB. ECON. 231, 231–32 (1983); Esty, *supra* note 64, at 619; Farrell & Saloner, *supra* note 106, at 70; Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424 (1985); Michael L. Katz & Carl Shapiro, *Systems Competition and Network Effects*, J. ECON. PERSP., Spring 1994, at 93; Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); Lemley & McGowan, *supra* note 136, at 515–16; S.J. Liebowitz & Stephen E. Margolis, *Network Externality: An Uncommon Tragedy*, J. ECON. PERSP., Spring 1994, at 133.

151 Lemley & McGowan, *supra* note 136, at 482–83.

152 See generally David, *supra* note 136, at 332; S.J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J.L. ECON. & ORG. 205, 210 (1995); William Magnuson,

the point seems like an obvious one (how could past decisions *not* affect today's decisions), the consequences are significant. In areas that exhibit strong path dependency, inefficient initial arrangements can seriously skew future decisions in a way that impedes more desirable reforms. Once a particular regulatory structure has become widely adopted, and the network effects are sufficiently high, the cost of switching to other regulatory structures that might *ab initio* have been more efficient can become prohibitive.

But it is important to note that not all regulations benefit from the same levels of interoperability benefits, and thus the race to the middle will have stronger or lesser force as a result. The extent of the interoperability benefits will depend, among other things, on the nature of the regulation and the activity regulated. Where there are large economies of scale or regulations are sufficiently complex that complying with multiple structures reaches a certain level of cost, interoperability benefits should push states to adopt middle structures, rather than top or bottom ones. On the other hand, when economies of scale do not exist or regulatory regimes do not impose high costs on actors, interoperability benefits will play a less important role in affecting the race to the middle.

4. Intervention

The final factor that drives states toward a race to the middle is the risk of federal intervention.¹⁵³ The observation here is a simple one: it is more likely that the national government will act to strike down a state's regulation if that regulation is an outlier. If, on the other hand, the state's regulation is well within the norms of behavior of other states, the national government will be less likely to intervene. To the extent that states seek to prevent the national government from stepping in to challenge or preempt their laws,

The Public Cost of Private Equity, 102 MINN. L. REV. 1847, 1890 (2018); Stephen E. Margolis & S.J. Liebowitz, *Path Dependence*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 17 (Peter Newman ed., 1998).

153 For discussions of the role of federal intervention in reaction to state law, see Jonathan H. Adler, *Cooperation, Commandeering, or Crowding Out?: Federal Intervention and State Choices in Health Care Policy*, 20 KAN. J.L. & PUB. POL'Y 199 (2011); Lucian Arye Bebchuk & Allen Ferrell, *Federal Intervention to Enhance Shareholder Choice*, 87 VA. L. REV. 993 (2001); Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793 (2006); Aziz Z. Huq, *Does the Logic of Collective Action Explain Federalism Doctrine?*, 66 STAN. L. REV. 217, 218 (2014) ("The observed inability of states to produce a collective good by acting together might therefore be a reliable signal of when federal intervention is needed."); Roe, *Delaware's Competition*, *supra* note 13, at 601 (arguing that "Delaware players have reason to fear that if they misstep, they will lose their lawmaking business" because they know that "the federal authorities, even if not breathing down their necks at every moment, could act if they so chose"); Robert B. Thompson, *Delaware's Dominance: A Peculiar Illustration of American Federalism*, in CAN DELAWARE BE DETHRONED? 57 (Stephen M. Bainbridge et al. eds., 2018) (discussing historical developments regarding the apportionment of corporate lawmaking responsibility between federal and state governments).

they will have an interest in adopting regulations that look similar to those of their peers, rather than distinguishing themselves from the crowd.¹⁵⁴

Federal intervention may take a number of forms. First, and most formally, it may come in the form of congressional action: Congress may pass laws to prohibit states from enacting regulations with certain content.¹⁵⁵ In some cases, Congress may be quite specific in the types of laws they are targeting. For example, when several states passed burdensome laws concerning trucking and shipping operations in their states, laws that made it more difficult for new entrants to compete with incumbent trucking companies, Congress stepped in to prohibit the practice, enacting in 1995 a law that prohibited states from enacting or enforcing any “law, regulation, or other provision having the force and effect of law related to a price, route, or service of any motor carrier . . . with respect to the transportation of property.”¹⁵⁶ Second, it may come in the form of actions by regulatory bodies or federal prosecutors seeking to challenge the state law as contrary to federal or constitutional law. A recent example of this kind of federal intervention has been seen in the debate around so-called “sanctuary cities,” or cities that seek to protect immigrants from deportation under federal law.¹⁵⁷ After President Trump took office in 2017, he issued an executive order for the Secretary of Homeland Security to prioritize deportation and to ensure that “sanctuary jurisdictions” that refuse to comply with their orders are held ineligible for federal grants.¹⁵⁸ Outlier states found that federal intervention could prove a powerful tool to thwart their legislative priorities.

Whatever its form, federal intervention in state regulation is more likely in the case of states with regulations that are viewed as outliers, or more extreme than the regulations of the majority of states. This is so for a number of reasons. First, outlier states are more likely to garner public attention and, thus, become the subject of politically motivated action. If a state adopts a law that looks quite similar to laws in other jurisdictions, it is less likely to gain political attention and salience. On the other hand, if a state adopts a law that goes much further than other states, either in pandering to powerful interests (in the case of races to the bottom) or in creating more efficient

154 Of course, there is public-choice literature suggesting that states sometimes prefer to allow the national government to intervene and thus give the state lawmakers a credible way to deflect criticism from their citizens for the content of their laws. See generally Morris P. Fiorina, *Legislative Choice of Regulatory Forms: Legal Process or Administrative Process?*, 39 PUB. CHOICE 33 (1982); Morris Fiorina, *Rational Choice and the New(?) Institutionalism*, 28 POLITY 107 (1995); Brian Galle, *Federal Grants, State Decisions*, 88 B.U. L. REV. 875 (2008); Christina E. Wells, *Katrina and the Rhetoric of Federalism*, 26 MISS. C. L. REV. 127, 143 (2006).

155 See generally Bebachuk & Hamdani, *supra* note 153 (describing the efforts of the federal government to replace state laws governing the duties of corporate insiders).

156 ICC Termination Act of 1995, Pub. L. No. 104-88, § 103, 109 Stat. 803, 899 (codified at 49 U.S.C. § 14501(c)(1) (2012)).

157 See Christopher N. Lasch et al., *Understanding “Sanctuary Cities,”* 59 B.C. L. REV. 1703 (2018).

158 Exec. Order No. 13,768, 82 Fed. Reg. 8799, 8801 (Jan. 25, 2017).

solutions to long-term problems (in the case of races to the top), the law is more likely to become a hot-button issue in public discussion.¹⁵⁹

Second, outlier states are more likely to have regulations that lead to extreme results that create demand for a federal response. State regulations that strongly favor the interests of one group over another can be expected to mobilize burdened groups to react, either by lobbying the state government to change its law or, if those efforts are ineffectual, by appealing to the federal government.¹⁶⁰ But regulations that simply copy the regulations in place in other jurisdictions can be expected to have more moderate effects on the interests of stakeholder groups and, thus, should generate fewer demands for intervention from the federal government.¹⁶¹

Perhaps it is an obvious point, but states fear federal intervention because it prevents them from enacting the laws they desire. Federal intervention by definition removes regulatory powers from the state and transfers it to the federal government, and thereby reduces the policy choices available to states. State legislators can no longer respond to the demands of their electorate by legislating in the area and thus may leave their constituencies restive.¹⁶² Federal intervention can also have real financial consequences for the state. For example, when South Dakota refused to raise its minimum drinking age to twenty-one, despite the demands of Congress in the National Minimum Drinking Age Act, the federal government withheld federal highway funding from the state.¹⁶³ Such conditional spending is common and can act as a powerful tool to pressure states toward more harmonized laws.¹⁶⁴

To be sure, in some cases, corporations may prefer federal action to state regulation, and thus, far from fearing federal intervention, they may actively desire it. Federal action, after all, can guarantee uniform legal structures across all states. And it can ensure that these benefits are not susceptible to later revision by state governments. But corporations will not always prefer federal intervention to state action. If, for example, they believe that they can achieve more desirable regulatory structures under state law than federal

159 See, e.g., THOMAS G. HANSFORD & JAMES F. SPRIGGS II, *THE POLITICS OF PRECEDENT ON THE U.S. SUPREME COURT* (2006); Robert A. Bernstein, *Directing Electoral Appeals Away from the Center: Issue Position and Issue Salience*, 48 POL. RES. Q. 479 (1995); Christopher Wlezien, *On the Salience of Political Issues: The Problem with 'Most Important Problem,'* 24 ELECTORAL STUD. 555 (2005).

160 See *Roe, Delaware's Competition*, *supra* note 13, at 601.

161 In pure races to the top, however, the risk of federal intervention may also be lower. Efficient regulations by definition promote the mutual interests of all groups and thus should not generate strong demand for federal intervention to change the regulations, except in those cases where a previously favored group loses its advantages under the new, more efficient rules.

162 But see *supra* note 154.

163 See *South Dakota v. Dole*, 483 U.S. 203, 205 (1987).

164 See Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentation*, 98 COLUM. L. REV. 267, 425–26 (1998); Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century*, 88 COLUM. L. REV. 1, 10–11 (1988); Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 HARV. L. REV. 1413, 1415–17 (1989).

law, they will prefer state action to federal action. Similarly, if they believe that federal action will be slow or delayed, a not implausible scenario in today's gridlocked Congress, they may prefer to focus their attentions on state law. In any case, federal intervention may have negative consequences not just for state regulators but also for the entities that are regulated by them.

B. *The Consequences of the Race to the Middle*

If the race to the bottom leads states to adopt laxer and more inefficient rules than their neighbors, while the race to the top leads states to adopt stricter and more efficient rules than their neighbors, the race to the middle causes states, instead, to imitate their neighbors.¹⁶⁵ Far from seeking to distinguish their regulatory models from the regulatory models present in other jurisdictions, states seek to adopt regulatory models that represent something akin to a consensus position. The ultimate result of the race to the middle is that state law becomes increasingly consistent, stable, and, except in certain extraordinary circumstances, unchanging.

In order to better understand the contours of the race to the middle, it is perhaps helpful to examine a hypothetical race. While this game theoretical model will necessarily be oversimplified, it demonstrates the power of the dynamic and how it is distinguishable from other types of races. To be sure, it presents the easiest case for a race to the middle—most real-life races will include variables that the hypothetical cannot capture. But once the initial dynamic is firmly established, we can begin to understand its limits.

Imagine there are two states, Amity and Comity, that are part of the United States but are located on a far-off continent and thus do business primarily with one another.¹⁶⁶ Each state is currently considering a reform to its corporate law. Neither legislature has updated its corporate law statute for some time, and thus their current laws are out of date and do not reflect developments in the corporate world. They have, however, reviewed the corporate statutes in other states to better understand their options, and they are now deciding on their final bills.

Race-to-the-bottom theorists would argue that Amity and Comity have two basic options. First, they can attempt to *improve* on other states' corporate laws, in an effort to craft a more efficient model. Alternatively, they can attempt to *undercut* other states' corporate laws, in an effort to curry favor with powerful corporations. Under a race-to-the-bottom model, the per-

165 As mentioned above in Section I.B, some scholars use the race-to-the-bottom rubric to describe a race to laxer standards, while others use it to describe a race to more inefficient standards. The same confusion exists among race-to-the-top scholars. See Swire, *supra* note 1, at 69–70.

166 For the purposes of simplicity, the hypothetical is structured as a two-player game. For further discussion of the permutations of such games in the development of legal structures, see DOUGLAS G. BAIRD ET AL., *GAME THEORY AND THE LAW* (1994); JAMES D. MORROW, *GAME THEORY FOR POLITICAL SCIENTISTS* (1994); Jack L. Goldsmith & Eric A. Posner, *A Theory of Customary International Law*, 66 U. CHI. L. REV. 1113 (1999).

ceived interests of the states in undercutting their neighbors outweigh any opposing interests in improving the substantive content of their laws. This strategic situation places them in a type of prisoner's dilemma: mutually, they would be better off if they adopted more efficient corporate law statutes, but, individually, each perceives an interest in defecting and undercutting its neighbor.¹⁶⁷ Importantly, regardless of the action taken by the other state, each state is better off if it undercuts the other state's corporate laws. This dominant strategy thus ensures that states will race toward less and less desirable regulatory structures as they seek to attract corporate presence. Table 1 below illustrates such a situation.

TABLE 1: THE RACE-TO-THE-BOTTOM GAME

		Comity	
		Undercut	Improve
Amity	Undercut	2, 2	4, 1
	Improve	1, 4	3, 3

Race-to-the-top theorists would agree on Amity and Comity's two basic options, but they disagree on the relative values of those options. Under a race-to-the-top model, the perceived interests of the states in improving their corporate laws greatly outweigh any interest in undercutting their neighbors. This strategic situation creates a type of virtuous "coincidence-of-interest" game, in which both states have strong interests in adopting progressively more efficient laws.¹⁶⁸ It is important to note that in this situation, each state has marginally higher payoffs if it improves its corporate law while the other state does not. This is so because the states are still competing to attract corporations to their jurisdictions, and thus if their own laws are more efficient than the laws of their neighbors, they will gain a competitive advantage. But such an interest does not negate the basic dynamic in the game, which leads to states continually seeking to improve the efficiency and desirability of their regulatory structures. Table 2 below illustrates such a situation.

TABLE 2: THE RACE-TO-THE-TOP GAME

		Comity	
		Undercut	Improve
Amity	Undercut	2, 2	1, 4
	Improve	4, 1	3, 3

167 See MORROW, *supra* note 166, at 263–68.

168 See Goldsmith & Posner, *supra* note 166, at 1122.

But what if Amity and Comity’s options are not limited to just undercutting or improving on other states’ corporate laws? What if, instead, they have a third option—attempting to *copy* other states’ laws in an effort to model their laws on precedent? Let us integrate into this model the concept that enacting the majority rule in place in other jurisdictions provides a set of benefits to the state—in the form of informational effects, familiarity effects, interoperability effects, and intervention effects. Table 3 below illustrates such a situation.

TABLE 3: THE RACE-TO-THE-MIDDLE GAME

		Comity		
		Undercut	Copy	Improve
Amity	Undercut	2, 2	1, 3	2, 2
	Copy	3, 1	4, 4	3, 1
	Improve	2, 2	1, 3	3, 3

As shown above, under the race-to-the-middle game, choosing the middle strategy, or copying the laws in place in other jurisdictions, is a dominant strategy. Regardless of what the other state does, the acting state is better off if it adopts a majority rule. This is so because the state realizes a benefit from harmonizing its rule with the rules from other jurisdictions. Under this stylized example, the benefit from situating one’s state in the “middle” of regulations outweighs any benefits from adopting a marginally more efficient rule or, alternatively, adopting a rule marginally more attractive to powerful interest groups.

The structure of the race-to-the-middle game leads to dramatically different results in the quality and distribution of law as compared with either the race-to-the-bottom model of federalism or the race-to-the-top model. The race-to-the-bottom dynamic leads states progressively to worsen their laws in pursuit of competitive advantage. As a result, the distribution of laws should tend to cluster near the “lower” end of efficiency. The race-to-the-top dynamic leads to the opposite result: states progressively improve their laws in pursuit of competitive advantage. As a consequence, the distribution of laws in a race to the top should tend to cluster near the “upper” end of efficiency. The race-to-the-middle dynamic, on the other hand, leads states progressively to harmonize their laws. As a result, the distribution of laws in a race to the middle will cluster more and more at a single point in the efficiency spectrum.

In order to better illustrate how the various races affect the quality of law *over time*, consider a set of states at an initial point in time (prior to the development of any races). Assume the quality of regulation is normally distributed, that is, that a few states have particularly low-quality regulation, a few states have particularly high-quality regulation, and the majority have some-

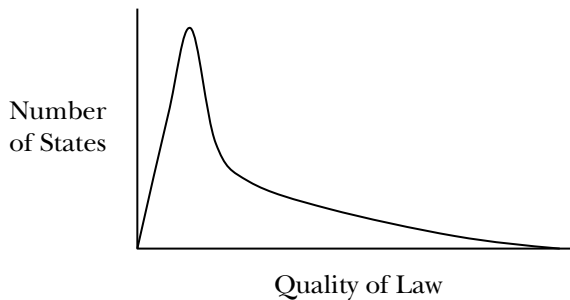
thing in between, neither exceptionally efficient nor exceptionally inefficient rules. Figure 1 below illustrates such a distribution.

FIGURE 1: INITIAL DISTRIBUTION OF REGULATORY QUALITY



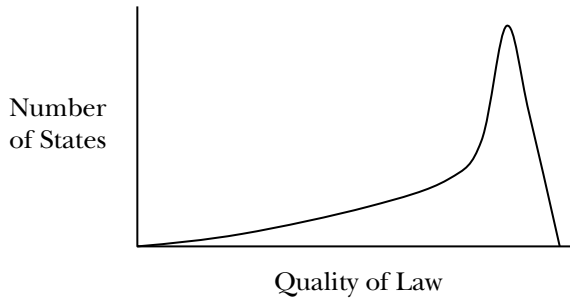
Under the race-to-the-bottom dynamic, with states consistently choosing to adopt worse law in order to cater to the interests of powerful constituencies, the quality of overall law within the states should steadily shift states toward the lower end of the spectrum of efficiency. The result should eventually resemble a log-normal distribution, with a cluster of states near the bottom and a few laggard states with more efficient laws in the long tail. Figure 2 below illustrates such a result.

FIGURE 2: REGULATORY QUALITY AFTER RACE TO THE BOTTOM



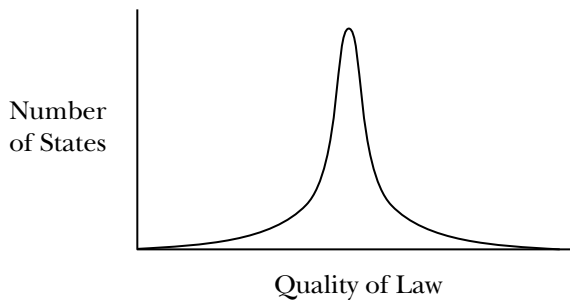
Similarly, under a race to the top, with states consistently seeking to improve the quality and efficiency of their laws, the overall quality of law should steadily shift higher. The result should eventually resemble a flipped version of the race to the bottom, with a cluster of states near the high end of the spectrum of efficiency, and a few laggard states with less efficient laws in the long tail. Figure 3 below illustrates such a result.

FIGURE 3: REGULATORY QUALITY AFTER RACE TO THE TOP



But the race to the middle leads to a very different result. Instead of leading to clusters of states at the upper or lower ends of regulatory quality, the race to the middle pushes states toward the preexisting dominant focal point of regulatory quality. So, if at the initial point in time, states were normally distributed along the spectrum of efficient laws, then the race to the middle should cause them to increasingly congregate at the midpoint of the distribution. Instead of shifting upward or downward in quality, the race simply reduces variation. Figure 4 below illustrates such a result.

FIGURE 4: REGULATORY QUALITY AFTER RACE TO THE MIDDLE



It should perhaps be noted here that the race-to-the-middle dynamic does not mean that states will necessarily congregate at a regulatory quality that is halfway between the two extremes of perfect efficiency and perfect inefficiency. As an initial matter, it seems unlikely that perfectly efficient law and perfectly inefficient law are sufficiently quantifiable that there even exists a “halfway” point. Take one commonly debated question in corporate law: the proper treatment of takeover defenses. Assuming that we can agree on the proper goals of corporate law,¹⁶⁹ and, further, that we can agree on

169 This, of course, is already an ambitious assumption, and one that is consistently proven ill founded. See, e.g., Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 549 (2003); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 735–36 (2005); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 638 (2006); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder*

whether those goals are promoted or undermined by takeover defenses,¹⁷⁰ it still is unclear that useful definitions of “perfectly efficient” and “perfectly inefficient” versions of takeover-defense law could be described with any numerical specificity. If we believe that corporate law’s sole goal is to promote shareholder value and that takeover defenses destroy shareholder value, is the perfectly efficient rule the one that prohibits all takeover defenses and the perfectly inefficient rule the one that allows all takeover defenses? Or is the perfectly efficient rule the one that affirmatively incentivizes takeovers, and the perfectly inefficient rule the one that affirmatively requires corporations to adopt all known (and future) takeover defenses? Would the halfway point be the rule that half of all takeover defenses are legal and half are not? As one can see, the question quickly devolves into confusion.

But more substantively, the race to the middle does not necessarily lead to a race to “mediocrity.” In some cases, the initial focal point among states for a particular regulatory structure may already be quite efficient. In others, it may be quite inefficient. In either case, the race to the middle will tend to push states toward that level of efficiency that has already been established. In essence, the race to the middle pushes states toward a harmonization of their laws, irrespective of the relative efficiency of that law.¹⁷¹

Now that the basic outlines of the race to the middle, and how it differs from the races to the extremes, have been set out, we may now proceed to examining the key conditions that make races to the middle possible. As the next Section will make clear, federalism does not necessarily lead to races to the middle—it just creates an environment in which such races are more likely.

Orientation in Comparative Corporate Governance, 50 HARV. INT’L L.J. 129 (2009); Henry Hansmann & Reinier Kraakman, Essay, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002).

170 Another dubious assumption. See, e.g., Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 409–10 (2005); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target’s Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1163–64 (1981); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 819–21 (1981); Lucian A. Bebchuk, Comment, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1030–31 (1982).

171 See, e.g., Simon Deakin, *Regulatory Competition Versus Harmonization in European Company Law*, in REGULATORY COMPETITION AND ECONOMIC INTEGRATION 190 (Daniel C. Esty & Damien Geradin eds., 2001); Amy Kapczynski, *Harmonization and Its Discontents: A Case Study of TRIPS Implementation in India’s Pharmaceutical Sector*, 97 CALIF. L. REV. 1571, 1572 (2009); Bruce H. Kobayashi & Larry E. Ribstein, *The Non-Uniformity of Uniform Laws*, 35 J. CORP. L. 327, 328 (2009); Jerome H. Reichman & Rochelle Cooper Dreyfuss, *Harmonization Without Consensus: Critical Reflections on Drafting a Substantive Patent Law Treaty*, 57 DUKE L.J. 85, 94–99, 102–08 (2007).

C. *Conditions for Races to the Middle*

The race to the middle occurs when states increasingly seek to assimilate their laws to dominant legal paradigms already existing in other states. The dynamic is made possible by the principles of federalism embedded in our constitutional system, and it is encouraged by several factors, including informational effects, familiarity effects, interoperability effects, and federal intervention effects. But the mere observation that states have *some* interests in racing to the middle does not tell us whether they will, in fact, do so, or, more importantly, whether their interests in racing to the middle will overcome other interests pushing them to the top or the bottom. So when precisely should the race-to-the-middle dynamic be expected to trump race-to-the-top or race-to-the-bottom dynamics in state regulation?

As an initial matter, races to the middle are more likely to occur when the informational benefits from previous regulations, the desire among stakeholders for familiar regulations, the importance of interoperability among state regulations, and the risk of federal intervention for outlier regulations are all high.¹⁷² Conversely, when these factors are less important to an issue area, or are not present at all, races to the middle are less likely to develop. In such situations, we would expect the value of “middle” regulations to decrease as compared with differential or niche regulations that are more consistent with the race-to-the-extreme models of federalism.

While it would be impossible to list all potential scenarios in which the benefits of racing to the middle are high, a few important conditions can be identified. First, when the preferences of the regulated group are relatively homogenous, a race to the middle is more likely.¹⁷³ One might posit, for example, that corporations have a relatively homogenous interest with respect to corporate income taxes—they prefer them to be low.¹⁷⁴ On the other hand, individuals have significantly less homogenous preferences with respect to contentious social issues such as abortion or gun control.¹⁷⁵ In the

172 See *supra* Section II.A.

173 For a discussion of the role of homogenous preferences in regulatory competition, see Bratton & McCahery, *supra* note 49, at 251–53; Dennis C. Mueller, *Centralism, Federalism, and the Nature of Individual Preferences*, 12 CONST. POL. ECON. 161, 162–64 (2001).

174 Even this anodyne proposition is not without its exceptions, of course. For example, after President Trump enacted a tax bill that cut corporate income tax rates from 35% to 21%, several companies, such as General Motors and Citigroup, took large charges to their earnings. They did so because the reduction in tax rates reduced the value of deferred tax assets (in other words, losses from previous years that could be used to offset income in future years). See Michael Rapoport, *Why New Tax Law Cost Citigroup, GM \$29 Billion*, WALL ST. J. (Jan. 17, 2018), <https://www.wsj.com/articles/why-new-tax-law-cost-citigroup-gm-29-billion-1516132375>.

175 A recent poll found that 57% of Americans believe that abortion should be legal in all or most cases, while 40% believe that it should be illegal in all or most cases. See *Public Opinion on Abortion*, PEW RES. CTR. (Aug. 29, 2019), <http://www.pewforum.org/fact-sheet/public-opinion-on-abortion/>. Similarly, a 2016 poll found that 50% of Americans are more concerned that government will go too far in restricting gun rights, while 47% of Americans are more concerned that government will not do enough to regulate access to guns.

former case, it is more likely that states will face similar incentives and thus can coordinate their regulations, while in the latter case, there is a greater likelihood that states will adopt diverging paths in order to appeal to discrete sectors of the population.

Second, when the regulatory regime at issue is complex, races to the middle are more likely.¹⁷⁶ When regulations are simple and straightforward, states have little to gain from the experiences and information effects of other states. The cost of formulating new laws is lower, and thus the risk of distinguishing one's own regulations from other state regulations is lower. On the other hand, regulations that require complex rules and standards of behavior to be formulated introduce new variables and risks for both states and constituencies, and thus the benefits of adopting well-tested regimes increase. Every effort to revise and amend behavioral rules is costly, regardless of whether the aim is to make the rules more attractive to favored groups or to make them more efficient.¹⁷⁷ Legislative processes are slow and cumbersome, particularly when the legislation is complex and affects a number of interest groups.¹⁷⁸ And as these regulations become more extreme, the cost of marginal improvements should increase. In these scenarios, states may well decide to take the middle approach in order to avoid the hard work of choosing sides on contentious issues.

In order to illustrate these points, it may be worthwhile to examine a few real-world examples of races to the middle. In these cases, far from constantly seeking to distinguish their regulations from other states, states have instead quickly coalesced around consensus regulatory outcomes. Their decisions have been driven by some combination of informational effects, familiarity, interoperability, and intervention risk.¹⁷⁹

One example of a race to the middle that has led to remarkable uniformity in state law is the proliferation of limited liability companies in the last few decades.¹⁸⁰ Until 1977, there were two basic forms of business organ-

See Carrie Dann, *Poll: Voters Divided on Government Role in Gun Control, Access*, NBC NEWS (June 26, 2016), https://www.nbcnews.com/meet-the-press/poll-voters-divided-govern-ment-role-gun-control-access-n598676?cid=par-aff-nbc-wrc_20160626.

176 For a more in-depth discussion of the role of legal complexity in society, see CASS R. SUNSTEIN, *SIMPLER: THE FUTURE OF GOVERNMENT* (2013); Adam I. Muchmore, *Uncertainty, Complexity, and Regulatory Design*, 53 Hous. L. Rev. 1321 (2016); Peter H. Schuck, *Legal Complexity: Some Causes, Consequences, and Cures*, 42 DUKE L.J. 1 (1992).

177 See Hannah J. Wiseman, *Regulatory Triage in a Volatile Political Era*, 117 COLUM. L. REV. ONLINE 240, 250–51 (2017) (describing the limited capacity of agencies to assess the costs and benefits of regulatory programs).

178 *Id.*

179 It should be noted that, in all of these cases, an argument could be made that the resulting arrangements are perfectly efficient (and thus a race to the top) or perfectly inefficient (and thus a race to the bottom). A full discussion of the relative efficiency of these laws is beyond the scope of this Article, but the high levels of conformity between states in these areas provides strong evidence that these areas are races to the middle, not races to the top or bottom, as further discussed above in Section II.A.

180 See Susan Pace Hamill, *The Story of LLCs: Combining the Best Features of a Flawed Business Tax Structure*, in *BUSINESS TAX STORIES* 295, 295–96 (Steven A. Bank & Kirk J. Stark

ization: corporations and partnerships.¹⁸¹ Corporations granted their shareholders limited liability for the company's debts, but they also imposed double taxation on their owners, with the profits of the corporation being taxed first at the entity level and then again once dividends were distributed to shareholders. Partnerships, on the other hand, imposed full liability on the owners for the partnership's debts, but granted their partners pass-through taxation status, with the profits of the partnership only being taxed once. But in 1977, the Wyoming legislature created a new entity, the limited liability company.¹⁸² This company incorporated the best characteristics of both corporations and partnerships: owners had limited liability and, simultaneously, single taxation. Initially, the regulatory status of LLCs was in some doubt—it was unclear whether regulators and judges would recognize the purported legal attributes of LLCs.¹⁸³ But in 1988, after the Internal Revenue Service issued a ruling that Wyoming LLCs would be granted pass-through tax status despite their limited-liability attributes, the LLC quickly starting proliferating.¹⁸⁴ By 1992, eighteen states passed LLC laws.¹⁸⁵ By 1993, thirty-six passed them.¹⁸⁶ By 1996, all fifty states had them.¹⁸⁷ The speed at which LLC regulations proliferated throughout the states was remarkable, but so was the uniformity of these regulations. One early survey of LLC provisions in state statutes found that, on average, 62.3% of states adopted the same substantive provisions with respect to third-party matters and 62.5% of states adopted the same substantive provisions with respect to

eds., 2005). Some scholars argue that the states' adoption of LLC law is an example of the race to the bottom. See J. William Callison, *Federalism, Regulatory Competition, and the Limited Liability Movement: The Coyote Howled and the Herd Stampeded*, 26 J. CORP. L. 951, 954 (2001) ("[T]he states' uncritical adoption of limited liability in reaction to tax regulatory changes can be viewed as a 'race-to-the-bottom.'"). Others argue that it is a race to the top. See ERIK P.M. VERMEULEN, *THE EVOLUTION OF LEGAL BUSINESS FORMS IN EUROPE AND THE UNITED STATES* 83 (2003) ("The LLC . . . tends to evolve towards efficiency."). Others reject both possibilities. See William W. Bratton & Joseph A. McCahery, *An Inquiry into the Efficiency of the Limited Liability Company: Of Theory of the Firm and Regulatory Competition*, 54 WASH. & LEE L. REV. 629, 633 (1997) (concluding that race-to-the-bottom and race-to-the-top explanations of LLCs are equally implausible).

181 There are, of course, many variations on these two forms, and the forms themselves look different in different jurisdictions. See Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 390 (2000); Henry Hansmann et al., *The New Business Entities in Evolutionary Perspective*, 2005 U. ILL. L. REV. 5.

182 See Bruce H. Kobayashi & Larry E. Ribstein, *Evolution and Spontaneous Uniformity: Evidence from the Evolution of the Limited Liability Company*, 34 ECON. INQUIRY 464, 472 (1996).

183 See Hamill, *supra* note 180, at 296 (discussing the uncertainty in the 1980s around how LLCs would be treated by the IRS).

184 See Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1460 (1998).

185 Hamill, *supra* note 180, at 297.

186 *Id.*

187 *Id.*

tax-related matters.¹⁸⁸ Later, after a Uniform Limited Liability Company Act (ULLCA) was promulgated, uniformity was even higher: where the ULLCA followed the “leading form” for a particular provision, an average of 69% of states adopted the same substantive rule.¹⁸⁹ But perhaps even more importantly, the basic structure of the LLC was firm. States did not seek to outdo one another with new, potentially even more favorable business structures, but rather adopted, increasingly over time, the most prevalent regulatory structure available.¹⁹⁰

Another recent example of a race to the middle can be found in the regulation of secured financing.¹⁹¹ Secured financing is the process by which one party to a transaction gains a security interest in the assets of the other party, meaning that the secured party has a claim on the assets in the event the other party defaults on its obligations.¹⁹² Secured transactions are widely used by financial institutions, corporations, and other businesses on a daily basis today, and they often have cross-border elements: a bank may give a loan to a company in one state, and it may seek security interests in the company’s assets in yet another state.¹⁹³ With the rise of syndicated loans in recent years, both the complexity and the importance of secured transactions have increased exponentially.¹⁹⁴ One could imagine that the interests of powerful actors (say, financial institutions) might cause states to engage in a race to the bottom, constantly seeking to reform their secured transactions laws in a way that favors financial institutions. But instead, states have adopted remarkably uniform provisions with respect to secured transactions. In 2010, when the UCC adopted a revision to its secured transactions provi-

188 See Kobayashi & Ribstein, *supra* note 182, at 476; see also ERIN A. O’HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* (2009); Bruce H. Kobayashi & Larry E. Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91, 94.

189 See Kobayashi & Ribstein, *supra* note 171, at 340. It should be noted that Professors Kobayashi and Ribstein conclude that the National Conference of Commissioners on Uniform State Laws, which promulgated the ULLCA, is in fact undermining uniformity in state law, not furthering it. *Id.* at 329.

190 With time, this uniformity may well increase. For example, one study of the Model Business Corporation Act (MBCA), which was originally drafted in 1950, concluded that 87% of states had adopted the MBCA’s mandatory provisions. William J. Carney, *The Production of Corporate Law*, 71 S. CAL. L. REV. 715, 731 (1998).

191 See generally Barry E. Adler & George Triantis, *Debt Priority and Options in Bankruptcy: A Policy Intervention*, 91 AM. BANKR. L.J. 563 (2017); Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996); Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV. 569 (1998); Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783, 1784–85 (1994).

192 For an excellent introduction to the process and results of secured transactions, see WILLIAM H. LAWRENCE ET AL., *UNDERSTANDING SECURED TRANSACTIONS* (5th ed. 2012).

193 See, e.g., DELOITTE, *GUIDE TO CROSS-BORDER SECURED TRANSACTIONS 1* (2013), <https://www2.deloitte.com/vi/en/pages/legal/articles/deloitte-legal-guide-to-cross-border-secured-transactions.html>.

194 See Elisabeth de Fontenay, *Do the Securities Laws Matter? The Rise of the Leveraged Loan Market*, 39 J. CORP. L. 725, 738–41 (2014).

sions—contained in article 9 of the UCC—it took less than five years for all fifty states to adopt the revised provisions.¹⁹⁵ Perhaps equally striking was the states' approach to one controversial issue that the UCC left open to states. Recognizing that there was some disagreement about the proper treatment of minor mistakes in the identification of debtors on the validity of security interests, the UCC offered states two alternatives: they could either adopt an "only if" rule that required strict conformance with the name requirements of the UCC or they could adopt a "safe harbor" rule that gave additional ways for creditors to properly identify debtors.¹⁹⁶ Prior to the revision, states had adopted widely diverging approaches to the rule. But once states started the process of revising their statutes, they quickly coalesced around a dominant strategy. Forty-four of fifty states adopted the "only if" rule, while only six states (including Delaware) adopted the more lenient "safe harbor" rule.¹⁹⁷ And it is easy to see why, under a race-to-the-middle model, this result would occur: secured transactions law is sufficiently complex that the cost of formulating innovative or different law is high; financial institutions and other large actors have strong interests in operating in jurisdictions that have familiar regimes; and the benefits of interoperable secured transactions regimes are large.

As both examples demonstrate, races to the middle are most likely to occur in areas that benefit from strong informational effects, familiarity effects, interoperability effects, and federal intervention effects. In the case of LLC law, the majority rule quickly gained acceptance around the country after initial doubts about its legal effects were resolved and states observed the popularity of the structure with businesses. In the case of secured transactions law, the rapid acceptance of the revised Uniform Commercial Code provisions was encouraged by the deep complexity of the law and the simultaneous need for interoperable state regimes. And importantly, the level of uniformity between states casts doubt on the relevance of either race-to-the-top or race-to-the-bottom models in explaining the spread of the legal regimes.

III. IMPLICATIONS OF THE RACE TO THE MIDDLE

Legal scholars have long debated how the principles of federalism embedded in our constitutional system affect the quality and substance of state law. These debates tend to revolve around two diametrically opposed positions: the race to the bottom and the race to the top. This Article, however, has argued that a third dynamic, the race to the middle, provides a powerful counterweight to these two models, and, in an increasingly complex

195 See PROPOSED 2010 AMENDMENTS TO UCC ARTICLE 9, PRACTICAL LAW PRACTICE NOTE 1-503-4438 (West 2019).

196 See Steven N. Cohen et al., *The 2010 Amendments to Article 9 of the UCC: A Primer*, MONDAQ, <http://www.mondaq.com/unitedstates/x/250158/Contract+Law/The+2010+Amendments+To+Article+9+Of+The+UCC+A+Primer> (last updated July 11, 2013).

197 See PROPOSED 2010 AMENDMENTS TO UCC ARTICLE 9, *supra* note 195.

regulatory environment, will likely grow in importance. But if we recognize that the race to the middle is an important dynamic in a federalist system, we must also recognize that it carries important implications for democratic governance. Among other things, it suggests that we must reassess debates about the virtues and vices of federalism. This Part will examine these questions in the context of three prominent strands of constitutional law theory.

A. *Laboratories of Democracy*

One common defense of federalism is that it allows states to experiment with different ways of governing their citizens.¹⁹⁸ By giving states wide regulatory discretion, and limiting the power of federal government to intervene in that discretion, our Constitution is thought to create “laboratories of democracy” in which states test out new ideas and theories about how best to arrange their affairs.¹⁹⁹ These laboratories, it is hoped, should gradually lead to better law as new regulatory “innovations” are created and deployed.²⁰⁰

The race-to-the-middle dynamic, however, suggests that states are not the active laboratories of regulation that many assume them to be. Instead of constantly experimenting with new and innovative regulatory structures, states often merely copy preexisting regulatory models from other states. Their tendency to copy rather than innovate is strongest when the regulations at issue are complex and the regulated behavior has cross-border implications. But these are precisely the kinds of areas in which innovation and experimentation should be most desired, given their applicability to other states and the increasing importance of complex regulatory structures. Where race-to-the-middle dynamics prevail, the state interest in improving their laws through experimentation will falter. Instead of vibrant laboratories of democracy, they will become assembly lines of conformity.

What is more, the race to the middle actively disincentivizes states from engaging in the regulatory entrepreneurship that underlies ideas of democratic laboratories. After all, if a state spends its time and resources to draft a new and better law, other states can easily copy these innovations without bearing the burdens of research and development that the original state did. And if other states quickly copy the approach, the competitive advantages to

198 See, e.g., *Fed. Energy Regulatory Comm’n v. Mississippi*, 456 U.S. 742, 788–91 (1982) (O’Connor, J., concurring in the judgment in part and dissenting in part) (“[T]he 50 States serve as laboratories for the development of new social, economic, and political ideas.”); *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) (“It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.”); Amar, *supra* note 23, at 1233–36.

199 See Amar, *supra* note 23, at 1234.

200 See *id.* (arguing that under a laboratory perspective of federalism, “federalism permits pragmatic testing of novel policy proposals”). But see Wiseman, *supra* note 111, at 1665–66 (arguing that states may well serve as laboratories, but they often fail to share information on their successes and failures with other states, thus severely limiting the upside of regulatory experimentation).

the initial state will be quickly eliminated. In other words, the second-mover advantage will disincentivize the first mover from moving at all.²⁰¹

If states are not the laboratories of democracy that proponents of federalism hope them to be, then discussions about federal powers and states' rights need to be revised to take this new model into effect. On the one hand, fears about destructive regulatory competition among states may be overblown, and thus calls for federal intervention to prevent races to the bottom should become less urgent. On the other, hopes for a virtuous cycle of ever evolving and improving state law are more precarious than they are widely believed to be, and thus new mechanisms to incentivize legal reform must be explored.

B. Tyranny of the Majority

The race to the middle also has important implications for debates about the limits of majority power. Democracy has long been viewed as a form of government directly opposed to tyranny, that is, unjust rule by the individual.²⁰² It does, however, raise another kind of risk: the risk of tyranny of the majority.²⁰³ If a group of individuals that make up a majority of the populace are united in a desire to oppress vulnerable minorities, whether they be racial groups, religious groups, or ideological groups, democracy provides them an effective means of doing so. The U.S. Constitution was designed with these concerns in mind. For example, James Madison wrote that "the invasion of private rights is chiefly to be apprehended, not from acts of Government contrary to the sense of its constituents, but from acts in which the Government is the mere instrument of the major number of the Constituents."²⁰⁴ Similarly, Thomas Jefferson stated that "though the will of the majority is in all cases to prevail, that will to be rightful must be reasonable; that the minority possess their equal rights, which equal law must protect, and to violate would be oppression."²⁰⁵ In order to reduce concerns about oppressive majority rule, the Constitution was structured to protect

201 See GILLIAN K. HADFIELD, *RULES FOR A FLAT WORLD* 8 (2017) ("Most governments don't scramble to invent cheaper, simpler, and more effective ways of regulating so they can attract more users to their system.").

202 See ARISTOTLE, *THE POLITICS* 78 (Stephen Everson ed., Jonathan Barnes trans., Cambridge Univ. Press 1988); PLATO, *THE REPUBLIC* 275–324 (Desmond Lee trans., Penguin Books 2d ed. 2003).

203 See ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 251 (J.P. Mayer ed., George Lawrence trans., Doubleday 1969) (1835) ("What is a majority, in its collective capacity, if not an individual with opinions, and usually with interests, contrary to those of another individual, called the minority?").

204 Letter from James Madison to Thomas Jefferson (Oct. 17, 1788), *as reprinted in* 1 *THE CONSTITUTION AND THE SUPREME COURT* 121, 122 (Louis H. Pollak ed., 1966) (emphasis omitted).

205 Thomas Jefferson, First Inaugural Address (Mar. 4, 1801), *in* THOMAS JEFFERSON: *WRITINGS* 492, 492–93 (Merrill D. Peterson ed., 1984).

minorities in a number of ways,²⁰⁶ from dividing powers among government branches, to protecting free speech rights of citizens, to guaranteeing the free exercise of religion.

Federalism has long been thought to serve as an effective bulwark against tyrannies of the majority.²⁰⁷ By dispersing government powers among a wide variety of polities, each with different interests and constituents, federalism serves to reduce concerns that a centralized power can force its will on the populace at large.²⁰⁸ Thus, decentralized decisionmaking, it is thought, should help prevent large groups from intentionally discriminating against disfavored minorities.

But the race to the middle suggests that federalism raises a *different* type of tyranny-of-the-majority problem. If states are racing to adopt the regulatory scheme that is dominant among other states, then majority approaches to regulatory problems gain an outsized weight in state decisionmaking. States that have different or opposed preferences may feel obliged to adopt nonoptimal (from their perspective) regulatory regimes simply because other states are doing so. And as more states adopt the majority approach, these forces should only increase in power.

Of course, the harms from this type of tyranny of the majority are potentially less objectionable than the harms from the classical version of the tyranny of the majority. The harm, in this case, stems not from the forcible oppression of the few by the many, but rather from the benefits that the few derive from willingly associating with the many. States receive a number of valuable benefits from assimilating their laws to the laws of other states, and many of these benefits accrue to their own citizens as well. States are voluntarily adopting the laws of the majority, and therefore where the race to the middle occurs, it occurs, not from direct oppression, but rather from an intentional exercise of legislative will.

But setting aside the question of whether the race to the middle raises concerns about state decisionmaking, it certainly indicates the power of momentum in federalism. Where it occurs, the race to the middle creates a set of path dependent effects among state regulations that are difficult to overcome. And if a sufficiently large group of states adopt similar regulations, those initial decisions can have an outsized effect on the shape and substance of other states' regulations. Federalism may, thus, lead to a tyranny of the consensus position.

206 See Mark V. Tushnet, *Following the Rules Laid Down: A Critique of Interpretivism and Neutral Principles*, 96 HARV. L. REV. 781, 784 (1983).

207 But see FEDERALIST NO. 10 (James Madison), *reprinted in* THE AMERICAN CONSTITUTION: FOR AND AGAINST 150, 155–56 (J.R. Pole ed., 1987) (arguing that factions are more likely to predominate in small localities, as opposed to the large nation).

208 See Will Kymlicka, *Federalism and Secession: At Home and Abroad*, 13 CANADIAN J.L. & JURIS. 207, 213 (2000); Richard Simeon & Daniel-Patrick Conway, *Federalism and the Management of Conflict in Multinational Societies*, in MULTINATIONAL DEMOCRACIES 338, 340 (Alain-G. Gagnon & James Tully eds., 2001).

C. *Voting with Your Feet*

Finally, the race to the middle has important implications for debates around voter choice and voter mobility. Federalism has long been thought to promote citizen autonomy by allowing citizens to choose among a variety of state regimes: if citizens do not like the government of the state in which they reside, they can “vote with their feet” and move elsewhere.²⁰⁹ Indeed, some scholars have argued that voting with one’s feet is the primary way in which individual citizens can influence their governments’ dictates.²¹⁰ After all, voting with one’s ballot—that is, actual voting—has little to no chance of affecting the result of an election, given the low likelihood that one vote will swing an election that includes millions of other votes.²¹¹ Thus, federalism has the advantage of giving citizens true political autonomy—they can choose to associate with the state governments of their choice.

An important premise of the argument about the choice-promoting effects of federalism is that citizens in fact have real choices between regulatory regimes—that is, that they can choose from a range of governments and laws that differ in meaningful ways. If, instead, citizens can only choose between states that have largely consistent regulatory structures, they cannot be said to have a true choice in governmental form. They will be bound by the same regulatory structures and rules whether they stay in their home state or they move elsewhere. If states, acting alone, decline to adopt sufficiently diverse regulations among themselves, then federalism’s promise of promoting citizen choice will be in vain.

But of course, as this Article has demonstrated, the race-to-the-middle dynamic creates strong pressures for states to reduce or eliminate differences in their laws. In order to take advantage of informational, familiarity, and interoperability benefits, states have a number of interests in harmonizing their laws with the majority approach of other states. Where the race to the middle occurs, then, citizen choice is necessarily diminished. State law becomes more uniform and nondistinct, and the range of available regimes declines. Voting with your feet is an ineffectual remedy when the race to the middle prevails.

To be sure, the race to the middle will not eliminate all state differences. Not all laws are subject to race-to-the-middle dynamics. And even where they are, the race-to-the-middle dynamic may not overcome other, contrary pressures pushing states toward other regulatory outcomes. In some cases, strong local preferences in favor of outlier or niche regulatory structures may be more powerful than any interest in the informational benefits of more com-

209 See ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* (1970); Ilya Somin, *Foot Voting, Federalism, and Political Freedom*, 55 *NOMOS* 83 (2014); Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 *J. POL. ECON.* 416 (1956); Mark E. Warren, *Voting with Your Feet: Exit-Based Empowerment in Democratic Theory*, 105 *AM. POL. SCI. REV.* 683 (2011).

210 See Somin, *supra* note 209, at 83–84.

211 *Id.* at 83.

monly adopted forms of regulation.²¹² In addition, there may be benefits for some states “specializing” their laws in order to appeal to certain subgroups of actors.²¹³ The most obvious case here is Delaware,²¹⁴ which is widely known as a corporation-friendly jurisdiction, but other examples include California²¹⁵ (with its particularly stringent environmental regulations) and Texas²¹⁶ (with its small-government, low-tax structure).

But even if the race to the middle does not lead to an elimination of state differences, it does suggest that the choice-promoting effects of federalism are overstated. Where the dynamic is strong, federalism can be expected to produce relatively uniform laws. This result would not be predicted by the race-to-the-extreme models of federalism, which, regardless of their independent merits, have the benefit of promoting freedom of choice. The race to the middle, on the other hand, reduces the range of policy choices available to citizens and undermines claims that “voting with your feet” is an effective method of individual autonomy.

CONCLUSION

This Article has argued that the dominant paradigms for understanding federalism are flawed. Both race-to-the-top and race-to-the-bottom theories of federalism rely on the assumption that states seek to distinguish their laws from those of their neighbor states—either by steadily undercutting, or by steadily improving on, their legal regimes. This assumption has often led commentators to the same tired policy prescriptions: either we need to increase federal intervention in order to prevent races to the bottom or we need to decrease federal intervention in order to enable races to the top.

But, this Article has argued, both race-to-the-top and race-to-the-bottom theories of federalism fail to account for the strong state interest in adopting laws that resemble or match prevalent laws in place in other jurisdictions. States that do so benefit from a number of valuable side effects, including greater information for legislators, more familiar legal regimes for corporations, and more interoperable legal rules. This state interest in conformity leads them to race to the middle, as more and more states adopt the plurality regulatory regime.

The consequences of the race to the middle are very much a mixed bag. On the one hand, it assuages concerns about the destructive effects of unfair competition between states. On the other, it casts doubt on optimistic assess-

212 See Bruce G. Carruthers & Naomi R. Lamoreaux, *Regulatory Races: The Effects of Jurisdictional Competition on Regulatory Standards*, 54 J. ECON. LITERATURE 52, 54 (2016).

213 See *id.*

214 See, e.g., Lucian Arye Bebchuk & Assaf Hamdani, Essay, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 553 (2002); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 526 (2001); Marcel Kahan, *The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?*, 22 J.L. ECON. & ORG. 340, 340 (2006); Klausner, *supra* note 150, at 841–46.

215 See Swire, *supra* note 1, at 81.

216 See *America's Future: California v. Texas*, ECONOMIST, July 11, 2009, at 11.

ments that federalism should lead to efficient law. When the race to the middle occurs, instead, we should see a drop in the diversity of laws. This reduces room for policy innovation by states, and it narrows the range of regulatory regimes available to citizens and companies. It also leads to the possibility that initial decisions by a small number of states will have large effects on future policy results, even if those initial decisions do not reflect the interests of a sizeable portion of society. The race to the middle suggests that we must rethink fundamental understandings about federalism's effects on the quality of law. It also calls for us to seek to find new ways of spurring policy innovation in a world of increasing conformity.

