

**FEDERAL REGULATION OF THE MUNICIPAL
SECURITIES MARKET: TESTING THE EFFICACY OF THE
POLITICAL PROCESS AS A TENTH AMENDMENT
LIMITATION ON CONGRESS**

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I. INTRODUCTION

The great Supreme Court Justice Louis Brandeis famously quipped in an article dated December 20, 1913, “Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”¹ Writing about the potency of publicity as a preemptive measure against abuses of power in the financial industry, the late Justice, with remarkable foresight, recognized the urgent need for disclosure in the financial markets to protect investors against fraudulent practices utilized by investment bankers and others involved in the offering and selling of securities.²

Twenty years and a crippling economic depression later, Congress filled Brandeis’ “sunlight” prescription by enacting the Securities Act of 1933 (Securities Act or 1933 Act). Soon afterwards Congress enacted the Securities Exchange Act of 1934 (Exchange Act or 1934 Act) establishing, among several important components of securities regulation, such as the Securities and Exchange Commission (SEC), the regulatory body responsible for enforcing the securities laws, mandatory disclosure requirements for issuers of securities.³ Since the initial implementation of the registration and reporting requirements for securities broker-dealers and issuers, the main thrust of securities regulation has continued to be disclosure.⁴

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¹ Louis D. Brandeis, *What Publicity Can Do*, HARPER’S WKLY., Dec. 20, 1913, at 10.

² *See id.* at 10–11.

³ *See* JOEL A. MINTZ ET AL., FUNDAMENTALS OF MUNICIPAL FINANCE 70 (1st ed. 2010).

⁴ *Id.* at 71.

Noticeably exempt from registration and reporting requirements in the Securities Act and the Exchange Act (collectively “the Securities Acts”), however, are municipal securities.⁵ “Municipal securities,” a term which encompasses a broad scope of sovereign debt instruments, generally refers to the debt issuances of state and municipal governments used primarily in financing capital projects, such as roads, school buildings, and sewer systems.⁶ In light of Justice Brandeis’ comment on disclosure being necessary to investor protection, it is only natural to inquire why municipal securities receive this preferred treatment and why municipal issuers are exempted from the registration and disclosure requirements to which corporate issuers of securities are subject.

Municipal issuers are not completely exempt from all provisions of the securities laws. They are bound by the anti-fraud provisions, for example Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act.⁷ Further, Congress and the SEC have amended the original Securities Acts with the Securities Acts Amendments of 1975 (1975 Amendments) and administrative rules, mainly Exchange Act Rule 15c2-12, adding several regulatory components specifically for municipal securities.⁸ As an example, the Municipal Securities Rulemaking Board (MSRB), one of the chief components of the 1975 Amendments, is a self-regulatory organization

⁵ See 15 U.S.C. § 77c(a)(2) (2018) (“Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of securities: . . . (2) Any security issued or guaranteed by the United States or any territory thereof, or by the District of Columbia, or by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of one or more States or territories”); 15 U.S.C. § 78c(a)(12)(A) (2018) (“The term ‘exempted security’ or ‘exempted securities’ includes—(i) governmental securities, as defined in paragraph (42) of this subsection; (ii) municipal securities, as defined in paragraph (29) of this subsection”).

⁶ U.S. Sec. & Exch. Comm’n, *Municipal Bonds*, INVESTOR.GOV, <https://www.investor.gov/introduction-investing/investing-basics/investment-products/bonds-or-fixed-income-products-0> [<https://perma.cc/M5E4-8HD5>] [hereinafter SEC, *Municipal Bonds*].

⁷ See *id.*; Martha Mahan Haines, Attorney-Fellow, Office of Mun. Sec., U.S. Sec. & Exch. Comm’n, *Disclosure in the Municipal Market: Fundamental Concepts for Issuers* (Sept. 19, 2000) (transcript available at <https://www.sec.gov/news/speech/spch400.htm> [<https://perma.cc/X6FX-N96A>]).

⁸ See U.S. SEC. & EXCH. COMM’N, REPORT ON THE MUNICIPAL SECURITIES MARKET, at ii–iii (2012), <https://www.sec.gov/news/studies/2012/munireport073112.pdf> [<https://perma.cc/34ZS-U66N>] [hereinafter SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET].

which Congress created specifically “to prevent fraudulent and manipulative acts and practices . . . and, in general, to protect investors and the public interest.”⁹ The MSRB assists the SEC in its oversight of the municipal securities market.¹⁰

Yet, despite these increases in federal involvement in the municipal securities market, the regulation of the municipal market remains light compared to the corporate securities market and inadequate in some commentators’ estimations.¹¹ Even in spite of the municipal market’s increased importance, complexity, and accessibility to retail or unsophisticated, household investors, and the increased number of defaults that have rocked the market’s confidence in the characteristic stability and safety of these instruments, the overall regulatory framework for the market has not changed as municipal issuers are still largely exempt from the requirements of the securities laws.¹²

The explanation for the special treatment of municipal securities from the majority of securities regulations has traditionally been broken down into three reasons. In a 2009 speech for the 10th Annual A. A. Sommer, Jr. Corporate, Securities and Financial Law Lecture, Commissioner Elisse B. Walter of the SEC, highlighted these three reasons for the exemption of municipal securities from the securities laws as: “(i) the lack of perceived abuses in the municipal securities market, compared with the corporate market; (ii) the fact that the typical purchasers of municipal securities are institutional investors with financial expertise; and (iii) intergovernmental

⁹ *Creation of the MSRB*, MUN. SEC. RULEMAKING BOARD, <http://www.msrb.org/About-MSRB/About-the-MSRB/Creation-of-the-MSRB.aspx> [<https://perma.cc/X7A5-FNRG>].

¹⁰ *See id.*

¹¹ SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 8, at ii. The lack of direct oversight of municipal issuers is the greatest inadequacy regulators and commentators alike see in the current regulatory framework. *See* Arthur Levitt Jr., *Muni Bonds Need Better Oversight*, WALL ST. J. (May 9, 2009, 12:01 AM), <https://www.wsj.com/articles/SB124182780923802551> [<https://perma.cc/ER5F-FMQY>]. Commentators suggest that municipal issuers should therefore be subject to direct oversight by the SEC and MSRB, and be required, for example, to follow uniform accounting principles in their financial reporting, and, further, be required to make periodic financial disclosures. *Id.* The lack of financial disclosures by municipal issuers is identified by some as a major fault line in the federal regulation of municipal securities. *See* Philip Grommet, *A Call for Action: An Analysis of the Impending Regulatory Crisis in the Municipal Securities Market*, 38 J. LEGIS. 237, 257 (2012).

¹² Nino C. Monea & James L. Tatum III, *State Sanctioned Fraud*, 4 BUS. & BANKR. L.J. 1, 5 (2016).

comity.”¹³ The Commissioner stated that these reasons are “no longer compelling” and that Congress needs to enact regulatory reform in the municipal securities industry.¹⁴

Time has partially confirmed former Commissioner Walter’s conclusion that the reasons for the exemption of municipal securities from the securities laws are “no longer compelling.” For many years, the muni market bore the reputation of being a “sleepy market,”¹⁵ but that label has since become a sort of misnomer as the aggregate value of the market has risen to an amount in excess of \$3.8 trillion.¹⁶ The common belief among legislators and marketplace participants at the time of the passage of the first securities laws was that this sleepy market was immune from the types of abuses that existed in the corporate securities market which had sparked the enactment of the securities laws in the first place.¹⁷ However, this belief has been tested and placed on precarious footing since the likes of New York’s 1975 fiscal crisis, the Washington Public Power Supply System default, and the Detroit and Puerto Rico bankruptcies in more recent times.¹⁸ One author said in an

¹³ Elisse B. Walter, Comm’r, U.S. Sec. & Exch. Comm’n, Regulation of the Municipal Securities Market: Investors Are Not Second-Class Citizens (Oct. 28, 2009) (transcript available at https://www.sec.gov/news/speech/2009/spch102809ebw.htm#P111_36590 [<https://perma.cc/T556-WG62>]).

¹⁴ *Id.*

¹⁵ Grommet, *supra* note 11, at 237.

¹⁶ *Investor Bulletin: The Municipal Securities Market*, U.S. SEC. & EXCHANGE COMMISSION (Feb. 1, 2018), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_munibondsmarket [<https://perma.cc/RT4E-ZA6M>].

¹⁷ Walter, *supra* note 13.

¹⁸ See ADELE C. MORRIS ET AL., THE RISK OF FISCAL COLLAPSE IN COAL-RELIANT COMMUNITIES 26–27(2019), https://www.brookings.edu/wp-content/uploads/2019/05/Morris_Kaufman_Doshi_RiskofFiscalCollapseinCoalReliantCommunities-CGEP_Report_FINAL.pdf [<https://perma.cc/2VRT-5HLB>]. The New York fiscal crisis of 1975 and Washington Public Power Supply System default are described in Part II of the comment. See *infra* Part II. The city of Detroit declared bankruptcy in July of 2013 becoming the largest U.S. city to file for Chapter 9 bankruptcy. *Detroit Leads 2013 U.S. Bond Defaults: Moody’s*, REUTERS (May 7, 2014, 12:16 AM), <https://www.reuters.com/article/us-usa-municipals-defaults-idUSBREA4603920140507> [<https://perma.cc/VD8W-JKSE>]. Detroit’s bankruptcy resulted in one of the largest municipal bond defaults in U.S. history, with the city defaulting on \$8.4 billion of outstanding municipal bonds. *Id.* Detroit’s historical default, which had been the largest municipal bond default in U.S. history, was later eclipsed by the fallout from Puerto Rico’s 2017 bankruptcy. Heather Long, *Puerto Rico Files for* (continued)

article published in 1996, that the front page of the *Bond Buyer*, a popular daily newspaper among the municipal finance world, “often reads like a local crime beat column” more than an investor’s newspaper.¹⁹ The growth of the market and the accompanying increase in abuse and corruption have made regulatory reform a higher priority for the SEC and certainly support the conclusion that a sleepy market is no longer a valid reason for exempting municipal securities from the majority of the securities laws.²⁰

Next, only sophisticated institutional investors, like insurance companies and employee pension systems with knowledge and appreciation of the risks associated with purchasing municipal bonds, traditionally invested in these securities.²¹ As such, regulators did not divert much energy to protecting these investors as they had the requisite faculties to discern risky or fraudulent investments.²² This statistic has likewise changed along with the increase in activity in the marketplace. Retail investors are now the overwhelming demographic in the municipal bond/securities market, so Commissioner Walter’s statement is accurate as to this reason being “no longer compelling.”²³

The third reason of “intergovernmental comity” is the focus of this paper. Intergovernmental comity is an outgrowth of the constitutional concept of federalism and has been described as “intergovernmental courtesy.”²⁴ This breed of comity is a principle that separate sovereigns, in the case of the United States, being the states and the federal government, will recognize each other’s legislative, executive, and judicial

Biggest US Municipal Bankruptcy, CNN (May 3, 2017, 2:50 PM), <https://money.cnn.com/2017/05/03/news/economy/puerto-rico-wants-to-file-for-bankruptcy/index.html> [<https://perma.cc/LK4F-LDVM>]. Puerto Rico’s bankruptcy involved an approximately \$73 billion debt restructuring. Dawn Giel, *Puerto Rico’s Oversight Board Strikes \$35 Billion Restructuring Deal with Commonwealth’s Bondholders*, CNBC (June 16, 2019, 9:49 PM), <https://www.cnbc.com/2019/06/16/puerto-ricos-oversight-board-strikes-35-billion-restructuring-deal-with-commonwealths-bondholders.html> [<https://perma.cc/GXM4-GF6F>].

¹⁹ Ann Judith Gellis, *Municipal Securities Market: Same Problems—No Solutions*, 21 DEL. J. CORP. L. 427, 428 (1996).

²⁰ Christopher Cox, Chairman, U.S. Sec. & Exch. Comm’n, *Integrity in the Municipal Market* (July 18, 2007) (transcript available at <https://www.sec.gov/news/speech/2007/spch071807cc.htm> [<https://perma.cc/7E5N-FBRF>]).

²¹ Walter, *supra* note 13.

²² Cox, *supra* note 20.

²³ *Id.*; Walter, *supra* note 13.

²⁴ Gil Seinfeld, *Reflections on Comity in the Law of American Federalism*, 90 NOTRE DAME L. REV. 1309, 1309 (2015).

prerogatives.²⁵ Article 4, Section 2 of the United States Constitution, the “Privileges and Immunities Clause,” is an example of interstate or “horizontal” comity.²⁶ Although, here, the focus will be “vertical” comity as this discussion will be limited to the interaction between the federal government, Congress, the SEC and MSRB, and the state and municipal issuers of securities.²⁷

Commissioner Walter, in her 2009 speech, emphasized that intergovernmental comity is not a federalism issue under the Tenth Amendment.²⁸ In her estimations, intergovernmental comity is more of a policy consideration, the balance of local interests of municipalities and their citizens versus the interests of the federal government in maintaining the “integrity” of the marketplace.²⁹ She compounded this statement by saying, “No one seriously questions anymore the Constitutional right of the federal government to regulate municipal issuers.”³⁰

Her statements are largely correct. For instance, Congress likely has the power to regulate municipal securities.³¹ Congress delegated complete authority and responsibility to the SEC for the regulation of the municipal securities industry,³² so the Commissioner is correct, to the extent Congress itself has the power to regulate the municipal securities industry, that the

²⁵ *Comity*, BLACK’S LAW DICTIONARY (11th ed. 2019) (“A principle or practice among political entities (as countries, states, or courts of different jurisdictions), whereby legislative, executive, and judicial acts are mutually recognized.”).

²⁶ Seinfeld, *supra* note 24, at 1317. In fact, the clause has alternatively been referred to as the “comity article” by the Supreme Court of the United States. *Id.* (quoting *Austin v. New Hampshire*, 420 U.S. 656, 660 (1975)). Black’s Law Dictionary contains an entry for the “Comity Clause,” which is the Privileges and Immunities Clause. *Comity Clause*, BLACK’S LAW DICTIONARY (11th ed. 2019).

²⁷ See Seinfeld, *supra* note 24, at 1309.

²⁸ Walter, *supra* note 13 (“The third rationale for exempting municipal securities—namely intergovernmental comity—is more difficult to dismiss. I should begin by noting that this is not a federalism issue under the Tenth Amendment to the U.S. Constitution, which limits the federal government’s ability to regulate state and local governments.”).

²⁹ *Id.*

³⁰ *Id.* (“For over 30 years the Commission has brought enforcement actions against municipal issuers for violations of the federal securities laws. No one seriously questions anymore the Constitutional right of the federal government to regulate municipal issuers.”).

³¹ See *infra* Part III. This conclusion is supported in Part III of the comment.

³² Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97.

SEC has the constitutional right to regulate municipal securities.³³ However, while the SEC has *a* constitutional right to regulate municipal securities, it does not have *the* absolute, unqualified right to regulate the municipal securities industry. As a delegee of Congressional power, it cannot exceed the power that Congress itself has to regulate the municipal industry.³⁴ If Congress is limited by the Tenth Amendment, then the SEC is likewise limited by the Tenth Amendment.

Despite the insistence of commentators like Commissioner Walters that intergovernmental comity is not a federalism or Tenth Amendment issue, the Tenth Amendment and federalism are inherent in the topic of federal regulation of municipal securities. The Tenth Amendment is triggered whenever discussing federal regulation of states and their political subdivisions.³⁵ Although proponents of full, direct regulation of the municipal securities market (i.e., eliminating the exemption of municipal securities from the main portion of the securities laws) are haste to deny that the exemption of municipal securities from the bulk of the securities laws is even remotely constitutionally compelled, the less vocal opponents, among academic circles at least, of direct regulation of municipal securities market, who exalt the sanctity of federalism, posit that the current regulatory scheme in the market is direct evidence of the constitutional compulsion of the exemption of municipal securities from the bulk of the securities laws.³⁶

They are partly correct. The exemption of municipal securities from the brunt of securities laws is not mere intergovernmental comity. It is the political process as a Tenth Amendment limitation on Congress. It is *Garcia v. San Antonio Metro. Transit Authority* in action.³⁷ In this 1985 case, the Supreme Court turned Tenth Amendment jurisprudence on its head by writing that Tenth Amendment limitations are inherent in the political

³³ See, e.g., *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 587–89 (1952). Outside of the executive branch’s enumerated powers in the Constitution, it only has the power to act in capacities in which Congress has delegated power. The *Youngstown Sheet & Tube Co. v. Sawyer* paradigm is particularly useful for analyzing executive action.

³⁴ *Id.*

³⁵ Gary Lawson, *A Truism with Attitude: The Tenth Amendment in Constitutional Context*, 83 NOTRE DAME L. REV. 469, 470 (2008).

³⁶ See COUNCIL OF STATE GOV’TS, RESOLUTION OPPOSING AMENDMENT OR REPEAL OF THE TOWER AMENDMENT 3, <http://www.csg.org/knowledgecenter/docs/TowerAmendmentResolution--Final.pdf> [<https://perma.cc/3H44-XU8Z>] (“The Tower Amendment recognized the constitutional prerogatives of state and local governments, and was crafted to balance those prerogatives with the perceived need for additional market regulation.”).

³⁷ See generally 469 U.S. 528 (1985).

process of Congress as each state has representation in the federal legislative body and the opportunity to protect its interests through the voting of its Congressmembers.³⁸ As opposed to being an external limit on Congress via a system of arbitrarily, judicially defined categories of “traditional government functions” with which Congress cannot interfere, the Tenth Amendment limitations are implicit in the laws that Congress passes and does not pass.³⁹ Municipal securities have largely been exempt from the securities laws since the enactment of the Securities Act of 1933, and with every subsequent securities law that Congress has enacted, Congress has chosen to continue to maintain this special treatment of municipal securities.⁴⁰ Laws have been proposed to remove the exemptions of municipal securities from the securities law, however, Congress has continued to protect the local interests and prerogatives of states and municipalities.⁴¹ Federal regulation of municipal securities seems to be a rare example of the *Garcia* Tenth Amendment approach in action, and it appears to be working for the states.⁴²

The purpose of this article is to address squarely the issue of the constitutionality of federal regulation of municipal securities, an issue which few authors have only tangentially discussed or briefly raised and dismissed finding that the answer is arguably obvious.⁴³ While there is much

³⁸ See *id.* at 555–56. The court said that the previous “traditional government function” approach taken in *National League of Cities v. Usery*, 426 U.S. 833 (1976) was “unworkable” and that the line between traditional government functions and where the federal government could interfere with state’s actions should be drawn by Congress as the representative body of the states and their citizens. *Id.* at 530–31. Although the Supreme Court later walked this decision back slightly in the case of *New York v. United States*, 505 U.S. 144 (1992), *Garcia* is still good law. See Kyle Richard, *Towards a Standard for Intergovernmental Tax Immunity between the Several States*, 70 TAX LAW. 869, 886 (2017) (“[T]he court has not substantively reconsidered the scope of the Tenth Amendment after *Garcia* . . .”).

³⁹ See *Garcia*, 469 U.S. at 556–57.

⁴⁰ 15 U.S.C. §§ 77r(a)–(b) (2018).

⁴¹ See, e.g., Thomas S. Currier, *Mandating Disclosure in Municipal Securities Issues: Proposed New York Legislation*, 8 FORDHAM URB. L.J. 67, 69–70 (1979) (“Additionally, bills were introduced in the Senate and House during 1975 and 1976 that would subject municipal issuers to the registration and periodic reporting requirements of the federal securities laws by deleting the exemption of municipal securities provided in section 3(a)(2) of the Securities Act.”).

⁴² See *Garcia*, 469 U.S. at 553–57.

⁴³ See Theresa A. Gabaldon, *Financial Federalism and the Short, Happy Life of Municipal Securities Regulation*, 34 J. CORP. L. 739, 740–41 (2009).

discussion about the necessity for regulatory reform in the municipal securities industry, there has been considerably less substantive discourse regarding the constitutionality of the current regulatory scheme in the industry and whether there are any constitutional barriers to increased regulations in this industry.⁴⁴

This comment concludes and argues that while Congress likely has the power to regulate municipal securities in interstate commerce pursuant to its commerce powers, Congress is bound by the political process as a Tenth Amendment limitation. Further, although the SEC, to the extent that it has been delegated the power by Congress, has the constitutional authority to regulate municipal securities, it cannot exceed the power delegated it by Congress. The Tower Amendment of the Securities Acts Amendments of 1975, which prohibits the SEC and MSRB from directly or indirectly requiring pre-sale disclosure from municipal issuers,⁴⁵ and the subsequent lack of legislation giving the SEC oversight of municipal issuers⁴⁶ is evidence that the political process is an effective Tenth Amendment limitation.

The special treatment reserved for the states and their political subdivisions in securities regulation is a result of “the procedural safeguards inherent in the structure of the federal system” which the *Garcia* decision left us with.⁴⁷ The argument of this comment is that while Congress could conceivably subject municipal securities to full regulation, Congress has not exercised this power for reasons explained in *Garcia*. Congress may eventually opt to regulate municipal securities equally with corporate securities, but until then, the inherent Tenth Amendment limitation in the federal legislative process has been effective in protecting the prerogative of states and their political subdivisions with their debt issuances.

The remaining three parts of this article will discuss the following: Part II will provide a brief history of the federal regulation of municipal securities and explain the current regulatory scheme of the market and lastly highlight how regulation of the municipal securities market has been limited because of constitutional compulsion. Part III will analyze Congress and the SEC’s constitutional authority to regulate municipal securities and will review the

⁴⁴ *Id.* at 742.

⁴⁵ 15 U.S.C. § 78o-4(d)(1) (2018).

⁴⁶ See SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 8, at iii. (“The [Securities Acts Amendments of 1975] did not create a regulatory regime for, or impose any new requirements on, municipal issuers. . . . The Dodd-Frank Wall Street Reform and Consumer Protection Act . . . did not change these provisions . . .”).

⁴⁷ *Garcia*, 469 U.S. at 552.

few Supreme Court cases that deal with municipal bonds and the Supreme Court's Tenth Amendment jurisprudence with an emphasis on *Garcia v. San Antonio Metro. Transit Authority*. Part IV will summarize the findings and conclude that full regulation of municipal securities is unlikely to happen at present due to inherent Tenth Amendment limitations in the political process.

II. HISTORY AND BACKGROUND OF FEDERAL REGULATION OF MUNICIPAL SECURITIES

“Soporific” and “antithesis of sexy” are just a few of the words authors have used to describe the topic of the federal regulation of municipal securities.⁴⁸ While often portrayed in a light of boringness and dismissed as complicated or uninteresting by both attorney and lay audiences,⁴⁹ municipal bonds are extremely important and largely responsible for many of the quotidian public structures, such as roads, bridges, and highways that citizens likely take for granted.⁵⁰

Municipal bonds, which are types of the broader category of municipal securities, are debt obligations of states, cities, counties, and other governmental entities.⁵¹ In everyday language, municipal securities are essentially loans.⁵² Municipalities issue debt to be sold to investors to finance daily operations of local government or fund capital projects, such as building schools, roads, or sewer systems.⁵³ Investors give money to the municipality in exchange for the municipality's promise to repay the full amount of the bond when it reaches maturity.⁵⁴ The municipality also makes, typically semiannual, interest payments to the investor as the price

⁴⁸ Gabaldon, *supra* note 43, at 740.

⁴⁹ *See id.*

⁵⁰ *See* SEC, *Municipal Bonds*, *supra* note 6. Former SEC Commissioner Luis Aguilar emphasized the importance of municipal bonds in this way, “There is perhaps no other market that so profoundly influences the quality of our daily lives. Municipal securities provide financing to build and maintain schools, hospitals, and utilities, as well as the roads and other basic infrastructure that enable our economy to flourish.” Public Statement, Luis A. Aguilar, Comm’r., U.S. Sec. & Exch. Comm’n, Statement on Making the Municipal Securities Market More Transparent, Liquid, and Fair (Feb. 13, 2015), https://www.sec.gov/news/statement/making-municipal-securities-market-more-transparent-liquid-fair.html#_edn40 [<https://perma.cc/GUX6-B89D>].

⁵¹ *Id.*

⁵² Monea & Tatum, *supra* note 12, at 4.

⁵³ *See* SEC, *Municipal Bonds*, *supra* note 6.

⁵⁴ *Id.*

of lending the money.⁵⁵ Lastly, the main peculiarity of municipal bonds is that the municipality pledges tax dollars or other security such as revenue from special projects as collateral for the bond.⁵⁶ These features are what make municipal securities unique from corporate debt securities, in addition to the more apparent reasons that they are issued by governments and that many are taxed favorably or not at all.⁵⁷

Despite the small fraction of academic attention given to this niche area of the law,⁵⁸ it is not for a lack of activity in the municipal securities market.⁵⁹ What once was considered the “small, sleepy corner of the nation’s capital markets” has become an increasingly complex and robust market attracting more independent investors.⁶⁰ There are currently \$3.84 trillion of municipal securities outstanding in the market.⁶¹ The market is fifteen times the size it was in 1975 with 40,000 state and municipal issuers.⁶² Considering the municipal market has grown to nearly half the size of the corporate securities market, which is worth \$9.2 trillion, the municipal market can no longer be called the “sleepy market”.⁶³ Although the municipal securities market is still largely unregulated in comparison to the corporate securities market, there has been a gradual increase in

⁵⁵ *Id.*

⁵⁶ See Margaret H. Lemos & Guy-Uriel Charles, *Patriotic Philanthropy? Financing the State with Gifts to Government*, 106 CALIF. L. REV. 1129, 1143 (2018). There are two main types of municipal bonds: general obligation bonds and revenue bonds. General obligation bonds are backed by the “full faith and credit” of states and municipalities and revenue bonds are secured by revenue earned from the financed project, such as tolls from a toll road. See *id.*

⁵⁷ See TAX POLICY CTR., BRIEFING BOOK 656–61 (2020).

⁵⁸ See Gabaldon, *supra* note 43, at 740. In 2009, only about 80 articles had been written on the topic of municipal securities regulation in the past 30 years. *Id.* at 740 n.2. Of these articles, few deal exclusively with the subject of municipal securities. *Id.*

⁵⁹ See Christine Sgarlata Chung, *Municipal Securities: The Crisis of State and Local Government Indebtedness, Systemic Costs of Low Default Rates, and Opportunities for Reform*, 34 CARDOZO L. REV. 1455, 1456–58 (2013).

⁶⁰ Monea & Tatum, *supra* note 12, at 5.

⁶¹ TAX POLICY CTR., *supra* note 5757, at 659.

⁶² Monea & Tatum, *supra* note 12, at 5.

⁶³ Bruce Blythe, *Muni Bond Basics for Investors: Know the Benefits & Risks*, TD AMERITRADE (Jan. 21, 2020), <https://tickertape.tdameritrade.com/investing/what-are-municipal-bonds-advantages-risks-17873> [<https://perma.cc/L9GY-9WFK>].

regulations of the former since the passage of the 1933 Act and the Exchange Act of 1934 (1934 Act or Exchange Act).⁶⁴

The history of municipal bonds in the United States dates back to the early nineteenth century.⁶⁵ It is a history of manifest destiny and westward expansion.⁶⁶ Municipal bonds financed the “expansion of the [young] American republic.”⁶⁷ The first recorded municipal bond in the United States was a general obligation bond issued by New York City in 1812 to finance the building of a canal.⁶⁸ The State of New York followed suit shortly after when it issued \$7 million in bonds to finance the construction of the Erie Canal, the success of which inspired other states to begin issuing debt to finance similar capital projects.⁶⁹

Although the practice of municipalities selling debt to finance projects has an extensive history, the federal regulation of debt instruments issued by municipalities is a relatively new phenomenon.⁷⁰ The first appearance of any federal attempt to regulate municipal securities appeared with the passage of the 1933 Act and then the following year with the 1934 Act.⁷¹ The Securities Acts subjected municipal securities and issuers to the antifraud provisions, which made it illegal for issuers and others involved in the sale of securities, both and municipal, to make fraudulent statements about the financial and debt instruments to investors.⁷² With the exception of these provisions in the Securities Acts, the regulation of the municipal securities market was effectively nonexistent until 1975.⁷³

⁶⁴ See Cornell Law Sch., *Securities*, LEGAL INFO. INST., <https://www.law.cornell.edu/wex/securities> [https://perma.cc/X5HL-ADUD].

⁶⁵ Steven Malanga, *The Muni-Bond Debt Bomb*, WALL ST. J. (July 31, 2010, 12:01 AM), <https://www.wsj.com/articles/SB10001424052748703999304575399591906297262> [https://perma.cc/2GAT-993G].

⁶⁶ See Jeanne T. Heidler & David S. Heidler, *Manifest Destiny*, ENCYCLOPEDIA BRITANNICA (Nov. 18, 2020), <https://www.britannica.com/event/Manifest-Destiny> [https://perma.cc/9MAR-AQ9Q]. “Manifest destiny” is the term for the nineteenth century American ideal of expanding west across the continent. *Id.*

⁶⁷ Malanga, *supra* note 65.

⁶⁸ *Id.*; see SEC, *Municipal Bonds*, *supra* note 6.

⁶⁹ Malanga, *supra* note 65.

⁷⁰ See Cornell Law Sch., *Securities Law History*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/securities_law_history [https://perma.cc/TV52-6UCL].

⁷¹ *Id.*

⁷² SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 8, at ii.

⁷³ *Id.*

A. *The Securities Act of 1933 and Securities Exchange Act of 1934*

“Bold, persistent experimentation” is what President Franklin Delano Roosevelt (F.D.R) said it would take to recover the United States from the depths of depression.⁷⁴ Securities regulation, implementing some system of accountability for issuers and brokers of financial products, was a piece of the “experimentation” that F.D.R. had promised during his presidential campaign.⁷⁵ He championed the idea of enacting laws to reform the financial industry and implement more safeguards for investors.⁷⁶ The Stock Market Crash of 1929 and the ensuing Great Depression left many bitter towards and distrustful of professionals in the financial industry, such as, bankers, financiers, and stockbrokers.⁷⁷ The 1933 Act was the first crucial step in regaining the public’s trust in the financial markets.⁷⁸

The 1933 Act forms the foundation of federal securities regulation along with the subsequent 1934 Act.⁷⁹ The basis of the Act is registration.⁸⁰ Section 3(a)(2) of the 1933 Act, however, explicitly exempts municipal securities from the registration requirements of the law.⁸¹ Congress purposely exempted municipal securities from the original securities laws, except for the antifraud provisions.⁸² The three reasons given in the introduction of this comment are the same reasons Congress applied in its decision to exclude municipal securities from the securities laws.⁸³ Most important of the reasons for exempting municipal securities was the fear Congress had for usurping constitutionally protected state sovereignty and interfering with state’s freedom to control their finances.⁸⁴

⁷⁴ *431 Days: Joseph P. Kennedy and the Creation of the SEC (1934-35)*, SEC. & EXCHANGE COMMISSION HIST. SOC’Y, http://www.sechistorical.org/museum/galleries/kennedy/lastDays_d.php [<https://perma.cc/NNA4-7ERP>] [hereinafter *Creation of the SEC*].

⁷⁵ *Id.*

⁷⁶ MINTZ ET AL., *supra* note 3, at 70.

⁷⁷ *Creation of the SEC*, *supra* note 74.

⁷⁸ See MINTZ ET AL., *supra* note 3, at 70.

⁷⁹ *Id.* at 71.

⁸⁰ *Id.*

⁸¹ See 15 U.S.C. § 77c(a)(2) (2018).

⁸² Stephen J. Weinstein, Attorney, Office of Mun. Sec., U.S. Sec. & Exch. Comm’n, *Municipal Securities in the Information Age: Responsibilities Under the Federal Securities Laws* (Oct. 3, 2000) (transcript available at <https://www.sec.gov/news/speech/spch408.htm> [<https://perma.cc/U9JZ-66NW>]).

⁸³ See MINTZ ET AL., *supra* note 3, at 70–71.

⁸⁴ *Id.* at 74–75.

The Exchange Act took the Securities Act one mark further by creating the Securities Exchange Commission, better known as the SEC.⁸⁵ Apart from creating the SEC, the primary difference between the 1933 and 1934 Acts is that the latter deals mainly with transactions of securities and regulates securities professionals, such as brokers and dealers,⁸⁶ while the Securities Act deals more so with the issuers of securities (i.e., the individuals selling their debt).⁸⁷ Between the Exchange Act and the Securities Act, the main emphasis of securities regulation is disclosure.⁸⁸ However, like the Securities Act, the Exchange Act exempts municipal issuers from its main provisions except for the antifraud provisions in Section 10(b) of the Act.⁸⁹

Congressional intent shows that there was a constitutional timidity in regulating municipal securities as they are governmental entities.⁹⁰ The record quoted below draws a comparison to intergovernmental tax immunity and concludes that municipal securities should be treated likewise.

The line drawn by the expression “political subdivision” corresponds generally with the line drawn by the courts as to what obligations of States their units and instrumentalities created by them, are exempted from Federal taxation. By such a delineation, any constitutional difficulties that might arise with reference to the inclusion of state and municipal obligations are avoided. These same constitutional limitations, real or imagined, upon Congress’ authority to subject governmental issuers to the regulatory scheme were an obvious factor leading to the exemption of such issuers from § 5 and § 12(2) of the 1933 Act.⁹¹

Until 1975, the only restrictions on municipal bonds were the anti-fraud provisions in the 1933 and 1934 Acts.⁹² There was no regulatory scheme

⁸⁵ See Cornell Law Sch., *supra* note 64.

⁸⁶ See Cornell Law Sch., *Securities Exchange Act of 1934*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/securities_exchange_act_of_1934 [<https://perma.cc/S59A-YAHB>].

⁸⁷ See Cornell Law Sch., *Securities Act of 1933*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/securities_act_of_1933 [<https://perma.cc/TK3L-EF3D>].

⁸⁸ TAX POLICY CTR., *supra* note 57, at 656.

⁸⁹ MINTZ ET AL., *supra* note 3, at 71.

⁹⁰ See H.R. REP. NO. 73-85, at 2 (1933).

⁹¹ *Woods v. Homes & Structures of Pittsburg, Kan., Inc.*, 489 F. Supp. 1270, 1281 (D. Kan. 1980) (quoting H.R. REP. NO. 73-85, at 14 (1933)).

⁹² See Public Statement, Aguilar, *supra* note 50.

for municipal securities before 1975, but the New York City fiscal crisis in 1975 changed everything as far as regulation of municipal securities.

B. The Securities Acts Amendments of 1975

“All municipals are not like the rock of Gibraltar.”⁹³ In other words, municipal securities, although characteristically safe investments, are not immune from default. The New York fiscal crisis of the early 70s served as a good reminder of this for investors and regulators alike. In October of 1975 New York city was on the brink of bankruptcy.⁹⁴ “America’s richest and largest city” was on the brink of financial ruin with \$453 million of debt scheduled to come due and yet, only \$34 million in available funds.⁹⁵ This near collapse incited Congress and the SEC to take a closer look at the municipal securities market which had largely passed unnoticed from Congress’ watchful regulatory eye.⁹⁶ New York’s near default resulted in a drastic change in the federal regulation of municipal securities, which were passed as part of the Securities Acts Amendments of 1975.⁹⁷

Following New York’s crisis, two bills were introduced in Congress to eliminate the exemption of municipal securities, under Section 3(a) of the 1933 Act, from mandatory disclosure requirements.⁹⁸ These bills, if passed, would have made the municipal securities subject to the same regulations as corporate securities as far as pre-sale disclosure requirements.⁹⁹ Congress, however, forewent the opportunity to make municipals subject to mandatory disclosure and instead added Section 15B to the 1934 Act creating the Municipal Securities Rulemaking Board.¹⁰⁰

The Municipal Securities Rulemaking Board is a unique, self-regulatory organization created specifically for brokers and dealers in the market

⁹³ A.M. HILLHOUSE, *MUNICIPAL BONDS: A CENTURY OF EXPERIENCE*, at xiii (1936).

⁹⁴ Jeff Nussbaum, *The Night New York Saved Itself From Bankruptcy*, *NEW YORKER* (Oct. 16, 2015), <https://www.newyorker.com/news/news-desk/the-night-new-york-saved-itself-from-bankruptcy> [<https://perma.cc/J6VN-D9X5>].

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *See generally* S. Res. 2574, 94th Cong., 121 CONG. REC. 33907 (1975); S. Res. 2969, 94th Cong., 122 CONG. REC. 3321 (1976).

⁹⁹ Gellis, *supra* note 19, at 431–32.

¹⁰⁰ *Id.* at 433.

place.¹⁰¹ It has rulemaking authority and is responsible for regulating the activities of broker-dealers, banks involved in the buying, selling, and underwriting of municipal securities, and municipal advisors.¹⁰² The MSRB is the “principal regulator” of the municipal securities market and works in conjunction with the SEC and the Financial Industry Regulatory Authority to enforce its rules.¹⁰³ While it is the principal regulator of the municipal securities market, the MSRB cannot directly regulate municipal issuers because of the Tower Amendment.¹⁰⁴

1. *The Tower Amendment*

The other important feature of the 1975 Amendments is what has become known as the Tower Amendment.¹⁰⁵ Although new regulations were established in the 1975 Amendments, the Tower Amendment limited the SEC and the MSRB in their ability to regulate municipal issuers.¹⁰⁶ It expressly negates the SEC and MSRB’s power to require municipal issuers to disclose any documents with either body before the sale of securities by the issuer.¹⁰⁷ The Tower Amendment is wildly unpopular with regulators

¹⁰¹ U.S. SEC. & EXCH. COMM’N, STAFF REPORT ON THE MUNICIPAL SECURITIES MARKET app. A at 4 (1993), <https://www.sec.gov/info/municipal/mr-munimarketreport1993.pdf> [<http://perma.cc/PH99-QE5L>].

¹⁰² MUN. SEC. RULEMAKING BD., THE ROLE AND JURISDICTION OF THE MSRB 2 (2018), <http://www.msrb.org/msrb1/pdfs/Role-and-Jurisdiction-of-MSRB.pdf> [<https://perma.cc/CL3E-Y65F>].

¹⁰³ *Id.* FINRA is a “government-authorized not-for-profit organization” that regulates the U.S. broker-dealers. *About FINRA*, FINRA, <https://www.finra.org/about> [<https://perma.cc/2JEQ-S2FZ>].

¹⁰⁴ Public Statement, Aguilar, *supra* note 50.

¹⁰⁵ *Id.*

¹⁰⁶ *See id.*

¹⁰⁷ Jay Clayton, Chairman, U.S. Sec. & Exch. Comm’n, Municipal Securities Conference: The Road Ahead—Municipal Securities Disclosure in an Evolving Market 12 (Dec. 6, 2018) (transcript available at <https://www.sec.gov/spotlight/municipalsecurities/municipal-securities-conference-120618-transcript.pdf> [<https://perma.cc/J5BD-MM8X>]). The Tower Amendment contains two sections and reads as follows, “[n]either the Commission nor the Board is authorized under this chapter, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the Board prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities.” 15 U.S.C. § 78o-4(d) (2018) (“The
(continued)

and academic commentators alike because it has led to “backdoor regulation” in the market and what some have called a “skewed” regulatory scheme.¹⁰⁸ Chief among the complaints that regulation of the municipal securities market is inadequate and needs to be reformed is the call for the repeal of the Tower Amendment.¹⁰⁹

Judge Richard Owen of the United States District Court for the Southern District of New York delivered an opinion in 1980 that offers a comprehensive insight into the legislative intent in passing the Tower Amendment.¹¹⁰ Writing on the purpose of the Tower Amendment, he said:

“[E]ven if regulation were limited to dealers, it would inevitably have consequences for issuers.” [This] prompted the adoption of the Tower Amendments. These Amendments attempted to limit the “collateral effect” of the 1975 Amendments on issuers in the following way

The aim of the Tower Amendments was to insure that the 1934 Act (as amended) would not “tamper in any way with prerogatives of state and local governments in their sale of securities.” Thus, in 1975 Congress merely ratified the approach taken in 1934 with respect to municipal securities.¹¹¹

Board is not authorized under this chapter to require any issuer of municipal securities, directly or indirectly through a municipal securities broker, municipal securities dealer, municipal advisor, or otherwise, to furnish to the Board or to a purchaser or a prospective purchaser of such securities any application, report, document, or information with respect to such issuer”).

¹⁰⁸ Monea & Tatum, *supra* note 12, at 5. “Backdoor regulation” means that the MSRB and SEC regulate municipalities through broker-dealers and underwriters. *Id.*; see Public Statement, Aguilar, *supra* note 50 (“Instead, the Commission indirectly regulates municipal securities offerings through its Rule 15c2-12, which requires underwriters of municipal securities offerings to obtain issuers’ disclosures for the securities they intend to sell and provide them to purchasers.”).

¹⁰⁹ See Public Statement, Aguilar, *supra* note 50 (calling for repeal); Walter, *supra* note 13.

¹¹⁰ See *Woods v. Homes & Structures of Pittsburg, Kan., Inc.*, 489 F. Supp. 1270, 1280–81 (D. Kan. 1980).

¹¹¹ *In re N.Y.C. Mun. Sec. Litig.*, 507 F. Supp. 169, 182–83 (S.D.N.Y. 1980) (citations omitted).

It chose, again, for possibly “obvious political reasons,” to exempt municipalities themselves from regulation while subjecting others in the municipal securities market to the Act’s regulatory scheme.¹¹²

2. Exchange Act Rule 15c2-12

Like New York’s fiscal crisis precipitated the 1975 Amendments, another fiscal tragedy in the early 1980s brought more regulation to the municipal securities market. In 1983, the Washington Public Power Supply System defaulted on \$2.25 billion of outstanding revenue bonds further shaking the investing world’s confidence in the historic stability of municipal bonds.¹¹³ The SEC responded to the Washington Public Power Supply System default by promulgating Rule 15c2-12.¹¹⁴

Rule 15c2-12 requires underwriters and dealers of municipal securities to “obtain and review” a municipal issuer’s final official statement before purchasing and selling the issuer’s bonds.¹¹⁵ This rule led to the “backdoor” regulatory scheme seen in the market today.¹¹⁶ Although the SEC is prohibited from requiring pre-sale disclosures directly from municipal issuers by the Tower Amendment, it is not prohibited from directly regulating the underwriters of municipal securities.

¹¹² *Id.*

¹¹³ Chung, *supra* note 59, at 1503. This cataclysmic default is sometimes referred to as “WHOOOPS” after the Washington Public Power Supply System’s acronym (WPPSS). MORRIS ET AL., *supra* note 18, at 26. The Washington Public Power Supply System had been issuing these bonds over several years to fund the construction of nuclear power plants, but due to a combination of poor management decisions and negative economic factors, the WPPSS defaulted. *Id.*

¹¹⁴ Gabaldon, *supra* note 43, at 743. The response was not immediate as the SEC spent six years investigating and compiling a report on the colossal WPPSS default. *Id.*; see also SEC. & EXCH. COMM’N, STAFF REPORT ON THE INVESTIGATION IN THE MATTER OF TRANSACTIONS IN WASHINGTON PUBLIC POWER SUPPLY SYSTEM SECURITIES (1988).

¹¹⁵ 17 C.F.R. § 240.15c2-12 (2021). (“[T]he Participating Underwriter shall obtain and review an official statement that an issuer of such securities deems final . . .”).

¹¹⁶ See Grommet, *supra* note 11, at 251. It is known as “backdoor regulation” because the SEC indirectly regulates municipal issuers “through the backdoor,” so to speak, by requiring municipal underwriters to request disclosure from the issuers before bidding, buying, or selling the bonds. *Id.* at 246.

Rule 15c2-12 represents the bounds of the SEC's authority to regulate the municipal securities market¹¹⁷ because despite continued defaults and fiscal crises negatively affecting investors in municipal securities,¹¹⁸ Congress has not repealed the Tower Amendment or removed the exemption of municipal securities from the main portions of the Securities Acts. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) is the most recent example of this.¹¹⁹

C. The Dodd-Frank Act

The Dodd-Frank Act, the most comprehensive piece of financial reform legislation since the Securities Acts, was signed into law on July 21, 2010.¹²⁰ The law was passed in response to the 2007-2009 financial crisis.¹²¹ Congress left no stone unturned in drafting the Dodd-Frank Act as the law touches nearly all corners of the financial markets, including the municipal securities market.

While the Dodd-Frank Act added several new regulatory components for non-sovereign participants in the municipal securities market, it did not change the overall regulatory scheme already in place in the market.¹²² Of the provisions of the Dodd-Frank Act dealing with municipal securities, one provision, that is of particular relevance to this discussion, required the U.S. Government Accountability Office to conduct a study of the municipal securities market and to make recommendations on whether to repeal the Tower Amendment.¹²³ The findings of the report were inconclusive though as some experts recommended repealing the Tower Amendment while others, including SEC and MSRB staff, stated that repealing the amendment

¹¹⁷ Chung, *supra* note 59, at 1506 (“In commenting on these and other reforms over the years, Commission staff have expressed the view that the Commission had reached at the outer reaches of its rule-making authority under 15c2-12.”).

¹¹⁸ See *supra* note 18 for description of recent municipal defaults.

¹¹⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376; see also SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 8, at iii (stating that the Dodd-Frank Act did not repeal the Tower Amendment or change the basic regulatory scheme in the municipal securities market).

¹²⁰ CONG. RESEARCH SERV., R41350, THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: BACKGROUND AND SUMMARY, at i (Apr. 21, 2017).

¹²¹ *Id.* at 1.

¹²² See SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 8, at iii.

¹²³ Chung, *supra* note 59, at 1517.

would not change anything as municipal securities would still be exempt under the Securities Acts.¹²⁴

D. Conclusion

Each period of new securities regulations and laws has demonstrated that Congress has consciously limited its own as well as the SEC's and MSRB's power to regulate municipal securities. The Securities Acts collectively exempted municipal securities from all the securities laws aside from the antifraud provisions.¹²⁵ Even though in 1975 Congress briefly entertained the idea of removing the exemptions of municipal securities in the original Acts and treating them equally as corporate securities, it ultimately eschewed full regulation for a limited regulatory scheme in the municipal market.¹²⁶ Congress, by creating the MSRB, chose instead to regulate the professionals (i.e., private individuals) in the industry as opposed to the state and municipal issuers themselves.¹²⁷ Further, the Tower Amendment was indicative of Congress' continued consciousness of not interfering with states' prerogative in issuing debt. When Congress, through the Dodd-Frank Act, reevaluated the federal government's regulation of the municipal securities market, it ultimately chose to continue to allow the special treatment of municipal securities under the federal securities laws. By expressly prohibiting the SEC and the MSRB from requiring disclosure from municipal issuers directly in the Tower Amendment,¹²⁸ and by maintaining the exemption of municipal securities from the brunt of the securities laws, Congress has demonstrated the efficacy of the political process as a Tenth Amendment limitation.

III. DOES THE SECURITIES AND EXCHANGE COMMISSION HAVE THE POWER TO REGULATE THE MUNICIPAL SECURITIES MARKET?

A. Background

In the sparse tundra of law review articles and other commentaries on the federal regulation of municipal securities, two forms of constitutional arguments have emerged. The first is simply that there is no constitutional

¹²⁴ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-698, MUNICIPAL SECURITIES: OPTIONS FOR IMPROVING CONTINUING DISCLOSURE 23 (2012).

¹²⁵ See Walter, *supra* note 13.

¹²⁶ Gellis, *supra* note 19, at 431–32.

¹²⁷ MUN. SEC. RULEMAKING BD., *supra* note 102, at 2.

¹²⁸ Public Statement, Aguilar, *supra* note 50.

issue with the federal regulation municipal bonds.¹²⁹ Federalism be damned, the exemption of municipal securities from the brunt of federal securities laws arises out of archaic notions of the municipal market being a sleepy market, the sophistication of the investors in the market, and intergovernmental comity,¹³⁰ not constitutionality.¹³¹ As Professor Gabaldon wrote, intergovernmental comity is “making nice to another government.”¹³² Thus, until present, the federal government has not directly regulated municipal securities, not because its hands are tied by federalism principles, but because it simply has been respectful of state sovereignty. To the proponent of direct regulation of municipal issuers, there is no true, external, barrier between Congress and direct regulation of municipal issuers. Certainly, there is no constitutional barrier.

Additionally, the Supreme Court has not heard the issue of the constitutionality of the federal regulation of municipal securities.¹³³ One reason is that the legislative history of the Securities Acts and the Tower Amendment does not contemplate the constitutionality of the acts, at least, not more than other considerations, such as intergovernmental comity or other policy reasons.¹³⁴ While, again, academic commentary on the constitutionality of federal regulation is nearly nonexistent, the consensus among the few who have addressed the topic is that the “betting money” is on the constitutionality of federal regulation of municipal issuers.¹³⁵ One

¹²⁹ See Walter, *supra* note 13 (“No one seriously questions the Constitutionality of federal regulation of municipal issuers.”).

¹³⁰ *Id.*

¹³¹ *Id.* (“The third rationale for exempting municipal securities—namely intergovernmental comity—is more difficult to dismiss. I should begin by noting that this is not a federalism issue under the Tenth Amendment to the U.S. Constitution, which limits the federal government’s ability to regulate state and local governments. For over 30 years the Commission has brought enforcement actions against municipal issuers for violations of the federal securities laws. No one seriously questions anymore the Constitutional right of the federal government to regulate municipal issuers.”).

¹³² Gabaldon, *supra* note 43, at 754.

¹³³ The Supreme Court has considered the constitutionality of the federal income taxation of the interest earned on municipal bonds however. See *generally* South Carolina v. Baker, 485 U.S. 505 (1988). Additionally, the Supreme Court has considered the status of municipal issuers with respect to the Full Faith and Credit Clause. See Bonaparte v. Tax Court, 104 U.S. 592 (1881). Beyond its borders, a state “is compelled to go into the market as a borrower, subject to the same disabilities in this particular as individuals.” *Id.* at 595.

¹³⁴ Grommet, *supra* note 11, at 249.

¹³⁵ See Gabaldon, *supra* note 43, at 754.

expressed reason for the lack of academic coverage of this topic is that the conclusion is arguably obvious.¹³⁶ The difficulty in accepting such statements is that they are conclusory and rely on the logical fallacy of “appeal to ignorance.”¹³⁷ The arguments largely are based on the fact that there is little discourse on the constitutionality of federal regulation of municipal securities and that no one seriously questions it; thus, it must be constitutional.¹³⁸ The result of using this style of reasoning (*i.e.*, the “appeal to ignorance”) is that nothing is proved except simply the fact that there is a lack of discourse on the subject.¹³⁹

B. Federalism and Tenth Amendment Limitations

Increased regulations tend to raise constitutional questions particularly when the subject involves the federal regulation of the states or its political subdivisions and instrumentalities. Since states and municipalities, which are considered to be political subdivisions of states,¹⁴⁰ issue debt securities,¹⁴¹ the Tenth Amendment applies wherever the federal government seeks to regulate state and local governments.¹⁴² While the constitutionality of the federal regulation of the municipal securities market seemingly has been accepted, the lack of discussion surrounding this topic does not mean constitutional issues do not exist within the regulatory framework of municipal securities. Staff of the Securities and Exchange Commission (SEC) have been dismissive of constitutional issues with federal regulation of municipal issuers.¹⁴³

Any time that Congress acts, the inherent constitutional question is, “Does Congress have the power to act?” In the system of dual sovereignty between the States and the Federal Government,¹⁴⁴ advanced by the Constitution, Congressional power is limited both by its vested powers under

¹³⁶ *Id.* at 741.

¹³⁷ *15 Logical Fallacies You Should Know Before Getting Into a Debate*, BEST SCHOOLS (June 9, 2020), <https://thebestschools.org/magazine/15-logical-fallacies-know/> [<https://perma.cc/LJG5-U7QX>] [hereinafter *Logical Fallacies*].

¹³⁸ Gabaldon, *supra* note 43, at 740, 753–54.

¹³⁹ *Logical Fallacies*, *supra* note 137.

¹⁴⁰ *Investor Bulletin: The Municipal Securities Market*, *supra* note 16.

¹⁴¹ *Id.*

¹⁴² Lawson, *supra* note 35, at 493.

¹⁴³ See Public Statement, Aguilar, *supra* note 50.

¹⁴⁴ *Gregory v. Ashcroft*, 501 U.S. 452, 457 (1991).

Article 1 of the Constitution and by the Federalism Doctrine.¹⁴⁵ Unlike states, which have broad plenary powers under the Constitution, Congress' power is limited to its enumerated powers in Article 1, Section 8 of the Constitution.¹⁴⁶ Those powers not granted to Congress in the Constitution are reserved to the states.¹⁴⁷ Under the confusing hierarchy of federal and state law, federal law supersedes state law when Congress is acting within its powers.¹⁴⁸ State laws that contravene Congressional actions taken within its constitutional powers are “preempted” or, in other words, not legally enforceable.¹⁴⁹ Conversely, Congress cannot act outside of its enumerated powers. When it is found to be sliding into the area of power reserved to the states by the Constitution, those enacted laws untethered to one of Congress' enumerated powers or one of Congress' workarounds such as, the Spending Clause or Taxing Power, are unconstitutional and not legally enforceable.¹⁵⁰ All this is to say that when analyzing whether Congress has the power to act with regard to a state government, its actions must be viewed first through the lens of its enumerated powers and secondly with an eye towards federalism and whether its actions invade that region reserved to state sovereignty.¹⁵¹

Congress has broad, sweeping, “plenary-esque” authority under the Commerce Clause. If a person, place, or thing is in interstate commerce, Congress can regulate it.¹⁵² Even if it is not, as long as the regulated person, place, or thing is rationally related, sometimes substantially related, to interstate commerce, chances are Congress can regulate it.¹⁵³ Although the Supreme Court has never heard a case directly relating to the constitutionality of the SEC and Congress' power to regulate municipal securities, Congress likely has the power to regulate municipal securities pursuant to its commerce clause powers.¹⁵⁴ Municipal securities are sold in

¹⁴⁵ ANDREW NOLAN ET AL., CONG. RESEARCH SERV., R45323, FEDERALISM-BASED LIMITATIONS ON CONGRESSIONAL POWER: AN OVERVIEW 3 (2018) (describing “federalism” as a doctrine based on the Tenth Amendment).

¹⁴⁶ *Gregory*, 501 U.S. at 460.

¹⁴⁷ *See* U.S. CONST. amend. X (“The powers not delegated to the United States by the Constitution . . . are reserved to the States respectively . . .”).

¹⁴⁸ NOLAN ET AL., *supra* note 145, at 3.

¹⁴⁹ *Id.* at 27.

¹⁵⁰ *Id.* at 1.

¹⁵¹ *Id.* at 2.

¹⁵² *Id.* at 7–8.

¹⁵³ *See id.* at 9–10.

¹⁵⁴ U.S. CONST. art. I, § 8.

interstate commerce, by broker-dealers in interstate commerce, to persons (i.e., investors) in interstate commerce. Therefore, simply with the surface information already stated, to the extent that municipal issuers are subjected to federal regulation under the Securities Acts, it is likely Congress has the power to implement such laws pursuant to its Commerce powers.

Article 1, Sec. 8 says, “The Congress shall have Power . . . to regulate commerce . . . among the several States”¹⁵⁵ Post-1937 until its *Lopez* decision, the Supreme Court interpreted Congress’ commerce power broadly.¹⁵⁶ Whether the subject of federal regulation is a channel of interstate commerce, an instrumentality of the same, or an intrastate activity that substantially relates to interstate commerce, Congress can regulate it as long as Congress has a rational basis to do so, or, as the Supreme Court has applied in some (intrastate) cases, as long as the regulated activity “substantially relates” to interstate commerce.¹⁵⁷

Issuing municipal bonds, as a function of state and local governments, does not fall neatly within the categories of channel, instrumentality, or intrastate activity with a substantial relationship to interstate commerce. As the Supreme Court recognized in *Dep’t of Revenue v. Davis*, the “issuance of debt securities to pay for public projects is a quintessentially public function.”¹⁵⁸ Justice Stevens added in his concurring opinion that “[a] State’s reliance on ‘ . . . municipal bonds’ to finance public projects does not merit the same Commerce Clause scrutiny as ‘operating a fee-for-service business enterprise in an area in which there is an established interstate market.’”¹⁵⁹ However, this case concerns the dormant Commerce Clause, which is a different constitutional concept altogether from the Tenth

¹⁵⁵ *Id.*

¹⁵⁶ See James Hinshaw, *The Dormant Commerce Clause After Garcia: An Application to the Interstate Commerce of Sanitary Landfill Space*, 67 *IND. L.J.* 511, 514 (1992) (“[The broad interpretation of the commerce power] enabled Congress to regulate activity in essentially any area regardless of the degree of its actual impact (or lack thereof) on interstate commerce.”).

¹⁵⁷ *NOLAN ET AL.*, *supra* note 145, at 9–10.

¹⁵⁸ *Dep’t of Revenue of Ky. v. Davis*, 553 U.S. 328, 342 (2008) (“By issuing bonds, state and local governments ‘sprea[d] the costs of public projects over time’ Bonds place the cost of a project on the citizens who benefit from it over the years, and they allow for public work beyond what current revenues could support. Bond proceeds are thus the way to shoulder the cardinal civic responsibilities listed in *United Haulers*” (citations omitted)).

¹⁵⁹ *Id.* at 358 (Stevens, J., concurring) (quoting *United Haulers Ass’n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 362 (2007) (Alito, J., dissenting)).

Amendment.¹⁶⁰ While the majority and concurring opinions characterize the issuing of debt to fund public interests as a unique and distinct practice deserving of a different level of Commerce Clause scrutiny than that afforded a private enterprise, this characterization is inapposite to the current discussion as it deals with horizontal comity and not federalism.

Congress likely has the power to regulate securities pursuant to its commerce power. However, does Congress' regulation of municipal securities issued by state and local governments violate the system of dual sovereignty enshrined in the Constitution?

Tenth Amendment jurisprudence has evolved from *National League of Cities v. Usury*,¹⁶¹ where the Court gave great deference to the discretion of states when acting in a traditional public function to a complicated, loose bundle of ideas that seem almost incompatible.¹⁶² While Justice Rehnquist's majority opinion in *National League* was overruled by *Garcia v. San Antonio Metropolitan Transit Authority*, an important concept from the *National League* opinion has survived and received new vitality following the "New Federalism Cases" of *United States v. Lopez* and *New York v. United States*. This is the idea that the federal government cannot "commandeer" a state or local government to enforce a federal policy.¹⁶³

Garcia is the "ugly duckling" of Tenth Amendment jurisprudence. It is "sandwiched" chronologically speaking between Supreme Court cases that support the concept of traditional government functions. Prior to the handing down of the *Garcia* opinion, the Supreme Court had been crafting its traditional government function interpretation of the Tenth

¹⁶⁰ The dormant Commerce Clause is a doctrine that says that states have concurrent power to regulate commerce as long as they do not negatively burden interstate commerce or discriminate against other states. *See id.* at 337–38 ("The Commerce Clause empowers Congress '[t]o regulate Commerce . . . among the several States,' and although its terms do not expressly restrain 'the several States' in any way, we have sensed a negative implication in the provision since the early days. The modern law of what has come to be called the dormant Commerce Clause is driven by concern about 'economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.' The point is to 'effectuat[e] the Framers' purpose to "prevent a State from retreating into [the] economic isolation"' 'that had plagued relations among the Colonies and later among the States under the Articles of Confederation.'" (citations omitted)).

¹⁶¹ 426 U.S. 833 (1976).

¹⁶² *See* Lawson, *supra* note 35, at 503.

¹⁶³ *Id.* at 496.

Amendment.¹⁶⁴ *National League of Cities v. Usery*, the traditional government function case which struck down the Fair Labor Standards Act provisions concerning minimum wage and maximum hour requirements for public employees, created the basis of the “anti-commandeering doctrine” that Congress could not interfere with states’ freedom to govern its own operations in “areas of traditional government functions.”¹⁶⁵ The Court revived this doctrine after the *Garcia* decision in *New York v. United States*,¹⁶⁶ and then *Printz v. United States*.¹⁶⁷ However, despite *Garcia*’s relevance being lessened slightly with the subsequent case of *Printz* and *New York v. United States*, it has not been overruled and is still the primary case for the Tenth Amendment.¹⁶⁸

In a five-to-four decision, the Court in *Garcia* overruled the *National League* opinion.¹⁶⁹ The Court, in *Garcia*, came to the exact opposite conclusion of *National League* and held that municipal transit workers were not exempt from the minimum wage and maximum hour provisions of the Fair Labor Standards Act.¹⁷⁰ The basis of the decision is that the true restraint on Congress’ commerce power is an internal limit implicit in the “system of congressional lawmaking.”¹⁷¹ As authors Debra Young and Thomas Gardiner recognize in their article, *Garcia v. San Antonio Metropolitan Transit Authority: The Commerce Clause and the Political Process*, the Court, by holding that there was no external limit on Congress’ commerce power, “refused to recognize any tenth amendment limitation on the federal government’s commerce clause power, a long-dormant limitation which had its modern genesis in the *National League of Cities* case.”¹⁷²

¹⁶⁴ See *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 531 (1985). *C.f. Nat’l League of Cities*, 426 U.S. at 858 (Brennan, J., dissenting).

¹⁶⁵ *Id.* at 849, overruled by *Garcia*, 469 U.S. at 531.

¹⁶⁶ 505 U.S. 144, 177, 186 (1992).

¹⁶⁷ See 521 U.S. 898, 941 (1997) (Stevens, J., dissenting).

¹⁶⁸ Charles Cooper, *The Constitution in One Sentence: Understanding the Tenth Amendment*, HERITAGE FOUND. (Jan. 10, 2011), <https://www.heritage.org/the-constitution/report/the-constitution-one-sentence-understanding-the-tenth-amendment> [<https://perma.cc/R4AR-RW5A>].

¹⁶⁹ *Garcia*, 469 U.S. at 531.

¹⁷⁰ *Id.* at 555–56; Debra E. Young & Thomas G. Gardiner, *Garcia v. San Antonio Metropolitan Transit Authority: The Commerce Clause and the Political Process*, 6 PACE L. REV. 599, 599 (1986).

¹⁷¹ *Id.*

¹⁷² *Id.* at 600.

Instead of the Tenth Amendment being an external limit to Congress' commerce powers, *Garcia* gave the concept of the political process being the true manifestation of the Tenth Amendment limitation of Congress' powers.¹⁷³

IV. CONCLUSION

In the nearly ninety years that the federal securities laws have been in existence, municipal securities have been exempted from largely all the requirements of the laws.¹⁷⁴ Despite the growth of the market to fifteen times its size when the original securities law were passed and the several colossal defaults and increase of corrupt practices in the market,¹⁷⁵ Congress has continued to avoid subjecting municipal securities to the full regulation under the securities laws. Congress has demonstrated through the lawmaking process that the political process works as an effective Tenth Amendment limit on its powers.

¹⁷³ *Garcia*, 469 U.S. at 552–54. The effectiveness of the federal political process in preserving the States' interests is apparent even today in the course of federal legislation. . . . [The States] have been able to exempt themselves from a wide variety of obligations imposed by Congress under the Commerce Clause. For example, the Federal Power Act, the National Labor Relations Act, the Labor-Management Reporting and Disclosure Act, the Occupational Safety and Health Act, the Employee Retirement Income Security Act, and the Sherman Act all contain express or implied exemptions for States and their subdivisions. The fact that some federal statutes such as the FLSA extend general obligations to the States cannot obscure the extent to which the political position of the States in the federal system has served to minimize the burdens that the States bear under the Commerce Clause.

¹⁷⁴ *Investor Bulletin: The Municipal Securities Market*, *supra* note 16.

¹⁷⁵ See Gellis, *supra* note 19, at 428; *Investor Bulletin: The Municipal Securities Market*, *supra* note 16.

