New Jersey Law Journal

VOL. CXCVIII - NO.9 - INDEX 782 NOVEMBER 30, 2009 ESTABLISHED 1878

IN PRACTICE

BUSINESS LAW

Curbing Federal Pre-emption: What It Means for State Regulation

BY PETER G. VERNIERO AND PAULA A. TUFFIN

For the past 10 years or so, federal preemption has been a safe-haven of sorts. If a company satisfied federal regulatory requirements, there was a decent chance that the company would be immune to state liability on issues that overlapped with federal law. Not so likely today.

In May, President Barack Obama issued a memorandum to the heads of all federal departments and agencies, declaring "that preemption of State law by executive departments and agencies should be undertaken only with the full consideration of the legitimate prerogatives of the States and with a sufficient legal basis for preemption." Translation: Whereas under the prior administration federal regulators might have looked for ways to pre-empt or displace their state counterparts, the current administration appears to be looking for ways to empower or partner with those same state regulators.

For those watching closely, there were signs that this policy shift was about to occur. In January, the National Association of Attorneys General (NAAG) announced that curbing federal pre-emption was its top issue of concern. According to a briefing paper prepared for then President-elect Obama's transition team, NAAG declared, "State Attorneys General have traditionally resisted federal pre-emption of state laws, whether by Congress, the Courts or the Executive Branch. Rather, state attorneys general have supported a more pure federalism, a dual sovereignty whereby state governments and the federal government each retain and actively exercise the powers and functions of government at the same time."

A few months later, in March, the concern over pre-emption was a topic of public discussion at NAAG's annual spring meeting held in Washington, D.C. The state Attorneys General (AGs) had gathered to hear U.S. Attorney General Eric Holder speak about a new level of cooperation between state and federal regulators. The AGs undoubtedly liked what they heard. "You have my personal commitment to building a genuine and open partnership with my colleagues in the states," Holder said. A few weeks later, the president issued his pre-emption memo. It is not difficult to connect the dots: the emerging regulatory climate appears to be one in which business entities increasingly will face both state and federal authorities in areas where they had previously confronted only federal agencies.

Moreover, this policy shift is not limited to future regulations. The president's pre-emption memo requires executive branch personnel to review regulations adopted within the past 10 years that might "contain statements in regulatory preambles or codified provisions intended by the department or agency to preempt State law [.]" Any such statements or provisions that do not have a sufficient statutory basis or cannot otherwise be justified under the new policy will be amended or rescinded, the president's memo suggests.

How should business entities respond? For starters, they can undertake the same review that is being conducted by federal department heads — meaning they can review the regulations governing their respective industries to identify those areas in which federal pre-emption may recede. This will give corporate leaders a better sense of what to expect from state regulators in areas once considered exclusive to federal regulation. The critical point is that unless a particular underlying federal statute clearly provides for pre-emption in a given area, such pre-emption can no longer be taken for granted.

Verniero and Tuffin are members of Sills Cummis & Gross in Newark. Verniero formerly served as a justice of the New Jersey Supreme Court and state attorney general and Tuffin formerly served as an assistant U.S. attorney in the southern district of New York. Their practice areas include corporate compliance and internal investigations. The views and opinions expressed in this article are those of the authors and do not necessarily reflect those of the firm.

Once a company identifies an area in which there might be concurrent federal-state jurisdiction, it should consider undertaking a review of its existing compliance programs from both a federal and state perspective. The multifactor test used by federal prosecutors to evaluate the effectiveness of compliance programs can provide a helpful framework of analysis. That test is set forth in the U.S. sentencing guidelines. It emphasizes compliance oversight, periodic evaluation of corporate compliance systems, and communications and other actions designed to foster a culture of compliance among corporate employees, especially among senior management. A company that has no formal compliance system in place or has not updated or reviewed an existing system in some time, should consider taking action to address either situation.

Similarly, to prepare for governmental inquiries that may originate from either the federal or state government or both, business entities should review existing document management policies to ensure that they are properly addressing the vast array of paper and electronic documents generated in today's marketplace. More specifically, this would be a good time for corporate managers to review the required retention periods in state and federal laws governing their companies. If a company has no document policy in place, it should consider establishing one. The touchstones of such policies are reasonableness, good faith and effective implementation. Particularly in the area of electronic discovery, companies sometimes find themselves in awkward situations where they have to explain to a governmental agency or to a court why documents have been lost or inadvertently destroyed. A thoughtful, effective document management policy can ameliorate problems down the road.

Lastly, companies might want to pay closer attention to what is happening in their state capitals in terms of newly adopted laws and regulations. Whereas in the past such rules might have had diminished reach because of federal preemption, today they may have greater impact. Again, nothing should be taken for granted. Also, with the possible rise of state regulation, businesses might see an increase in multistate actions in which neighboring AGs undertake joint enforcement action. This regulatory climate likely will place a premium on effective compliance systems and sound corporate governance.

To sum up: It remains to be seen what this shift of policy away from pre-emption will mean to corporations and those charged with overseeing corporate compliance programs. At a minimum, we predict that state attorneys general and other state regulators will become more active in areas traditionally dominated by federal departments and agencies – such as financial and securities regulations, to name just two. In other words, business entities, including their boards of directors and audit committees, might soon be navigating an expansive regulatory landscape from both a state and federal perspective.■