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NOTES

Is FINRA a State Actor? A Question that Exposes the Flaws of the State Action Doctrine and Suggests a Way to Redeem It

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I. INTRODUCTION

For over seventy years, the National Association of Securities Dealers ("NASD") was the principal self-regulatory organization
("SRO") responsible for the regulation and oversight of the U.S. securities market. In 2000, working with the Securities and Exchange Commission ("SEC") and the New York Stock Exchange ("NYSE"), the NASD initiated a joint investigation into twelve investment firms that were allegedly "spinning" initial public offerings. This sort of regulatory interplay between the NASD and the NYSE governed the industry until 2008, when self-regulatory power was further consolidated by a merger between the NASD and the regulatory arm of the NYSE. The resulting organization, the Financial Industry Regulatory Authority ("FINRA"), is now the dominant SRO in the securities industry.

Among the twelve firms investigated for spinning, the NASD oversaw the inquiry into Credit Suisse First Boston ("CSFB"). Frank P. Quattrone, managing director of CSFB's Global Technology Group, became aware of the investigation in September 2000. In December, Quattrone sent an email that directed his employees "to follow the firm's document retention policy," apparently a euphemistic authorization to destroy crucial files.

The NASD subsequently issued a written request for Quattrone to appear in an "on-the-record interview." It was clear that Quattrone would be questioned about his possible obstruction of the

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2. "Spinning" is a term of art referring to the practice of allocating shares of a hot initial public offering ("IPO") to the personal accounts of favored clients in the expectation that the client will resell or "flip" those shares for a profit. Generally speaking, these IPO allocations are made with the hope that the beneficiaries will return the favor in the form of future business. See generally Therese H. Maynard, Spinning in a Hot IPO—Breach of Fiduciary Duty or Business as Usual?, 43 WM. & MARY L. REV. 2023 (2002).
4. See Press Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Fin. Indus. Regulatory Auth.—FINRA (July 30, 2007), available at http://perma.cc/AK9S-RHLV (describing how the combined entity is designed to protect investors through regulation, compliance, and technology-based services). This Note will identify both the NASD and FINRA as "FINRA" when discussing them in general terms. However, the NASD will be used when referring to that organization in its particular historical context. See Part III for further information on the incorporation of FINRA into a private regulatory body.
5. Id.
7. Id.
8. Quattrone, supra note 3, at 3.
spinning investigation.¹⁰ The SEC sent a letter of its own, highlighting the "joint nature" of the investigation and that "any resolution of the matter will involve all three regulators."¹¹ Quattrone declined the interview on Fifth Amendment grounds, citing a pending criminal investigation against him for the same misconduct.¹² The NASD charged Quattrone with violating its rules.¹³ It rejected his Fifth Amendment claim, reminding him that "the Fifth Amendment 'restricts only government conduct,' " not private conduct by "a [self-] regulator."¹⁴ Subsequently, the NASD barred Quattrone from practicing in the securities market until he appeared for testimony.¹⁵

The state action doctrine embodies the fundamental principle that the Constitution only regulates government conduct.¹⁶ Constitutional claims against a private entity are only valid if the entity is properly considered a state actor under the doctrine.¹⁷ Despite the NASD's terse declaration that it is not a state actor, that conclusion is far from clear, and NASD's confidence is by no means shared by courts and scholars.¹⁸ Certainly, a joint investigation by a

¹⁰. While the request did not specifically mention allegations of document destruction—instead, justifying the need for further testimony "to determine whether NASD or federal securities laws were violated"—the underlying rationale was clear given that the request was issued the same day as a criminal investigation had been opened by both New York State and the U.S. Attorney's Office for the Southern District of New York on the possible illegal destruction of CSFB documents. See Quattrone, supra note 3, at 4 (noting that Quattrone's attorney received phone calls the morning after receiving the request from both offices notifying him of the criminal investigations).

¹¹. Id. at 5 (emphasis added).

¹². Id.; see also Press Release, supra note 9 (stating that Quattrone further asserted that NASD violated its statutory duty to provide him fair opportunity to defend himself).

¹³. Quattrone, supra note 3, at 3.

¹⁴. Press Release, supra note 9 (emphasis added). The NAC highlighted several factors—NASD's incorporation as a private corporation, the absence of any state or federal funding, and the independence of its Board of Directors from government interference—in finding against state actor status. Id.

¹⁵. Id.

¹⁶. There are a handful provisions in the Constitution that do apply to private entities, such as the 13th Amendment. But these provisions have been interpreted to textually target private entities.

¹⁷. See, e.g., Quattrone, supra note 3, at 11 ("[W]e consider the burden of demonstrating joint activities sufficient to render NASD a state actor to be high . . . "). The NAC decision was appealed to the SEC, which decided to remand the case on procedure, but added, in dicta, that Quattrone's Fifth Amendment assertions will require an analysis of state action doctrine. Id. at 10-11.

¹⁸. See, e.g., William I. Friedman, The Fourteenth Amendment's Public/Private Distinction Among Securities Regulators in the U.S. Marketplace—Revisited, 23 ANN. REV. BANKING & FIN. L. 727, 731–32 (2004) (attempting to make the argument that while traditionally recognized state action categories used by the Court would have precluded a finding of state action for NASD/FINRA, Brentwood Academy finally introduced analysis that opened the door to the SRO's inclusion as a state actor).
federal agency and a private entity could be state action if a reviewing court relied on the Supreme Court's latest conception of the doctrine. The SEC's letter to Quattrone in February 2003—noting that a resolution of the investigation would need to involve all three regulators—is evidence of the type of "entwinement" or "joint participation" that a court could use to find state action. However, entwinement and joint participation comprise but a small subset of the relevant factors.

This Note will attempt to show that the ambiguity of FINRA's status as a state actor is an unfortunate consequence of the ambiguities in the state action doctrine itself. Given the highly fact-specific inquiry of the Supreme Court's state action analysis, the doctrine is not consistently applied unless a very similar case has already been reviewed by the Court. However, the Supreme Court has yet to apply the state action doctrine to an SRO like FINRA.

Part II of this Note tracks the evolution of the state action doctrine, mapping the theories that the Supreme Court has used to demarcate the public/private sphere. This Part emphasizes the overlapping and contradictory contours of the state action doctrine, highlighting the arbitrary nature of the various rationales proffered by the Court.

Part III briefly lays out the history of the NASD and FINRA, identifying the factors that are most relevant to its state actor status.


22. As this Note will demonstrate, while there are traditionally two or three overarching state action exceptions distilled from Supreme Court cases reaching back to 1883, a myriad of subfactors, and even a potentially new overarching exception, have been relied upon by the courts to find for or against state actor status.

23. See Robert J. Glennon, Jr. & John E. Nowak, A Functional Analysis of the Fourteenth Amendment "State Action" Requirement, 1976 SUP. CT. REV. 221, 221–22 (discussing the evolution of the doctrine into a factually charged inquiry); see also infra text accompanying notes 50–57.

Mapping out FINRA’s history, structure, and relations with the state is necessary for a meaningful state action analysis.\footnote{25 See, \textit{e.g.}, Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass’n, 531 U.S. 288, 292–93 (2001) (looking at the history, structure, and relationship of the TSSAA with the state).}

Part IV highlights the malleability of the current state action doctrine, by showing that FINRA’s status as a state actor can be switched on and off depending on which facts are emphasized and which theory of state action is applied. This exercise shows why the current state action doctrine does not provide adequate guidance for judges to arrive at consistent results for SROs. Clear and consistent rules are all the more imperative given the pervasive reach of governmental collaboration in the private sphere, a condition that is not expected to decline anytime soon.\footnote{26 See Francis E. Rourke, \textit{Bureaucracy in the American Constitutional Order}, 102 \textit{Pol. Sci. Q.} 217, 217 (1987) (discussing the increasing pervasiveness of American bureaucracy); \textit{see also Developments in the Law—State Action and the Public/Private Distinction}, 123 \textit{Harv. L. Rev.} 1248, 1250 (2010) [hereinafter \textit{Developments in the Law}] (“As the public becomes more private, and the private becomes more public, the contours of the state action doctrine may come to define the contours of our most basic constitutional rights.”).}

Finally, Part V attempts to resolve these ambiguities by introducing a new methodological scheme that will consolidate the various branches of state action theory under one framework. This framework is more coherent because it forces an inquiry into the \textit{purposes} behind the public/private distinction. In other words, this new framework relies on the functional need for limiting some private action through constitutional constraints.

Moreover, the effectiveness of any framework depends on how well it resolves the state action concerns with FINRA, as well as whether it can be generally applied to the toughest state action cases. Otherwise, the new theory will simply be relegated to the grab bag of state action theories, capable of manipulating facts to arrive at unpredictable conclusions about the status of a private party. This Note contends that the framework proposed here could replace the patchwork of overlapping and contradictory factors that currently define the state action doctrine.

\section*{II. Evolution of State Action}

The Supreme Court has held that the Constitution governs only the conduct of the state, while conduct by purely private actors falls beyond its reach. Courts were able to readily distinguish between public and private conduct during the nineteenth century, an era of limited state-provided services. As the state became progressively
involved in private life, however, courts found it difficult to detect that constitutional threshold. In response, the Supreme Court gradually expanded its initially straightforward inquiry into the current state action doctrine, involving a set of theories through which it can bring certain types of quasi-private activity into the fold of state action. However, the Court functionally expanded the doctrine without ever expressly overruling its formalist holdings. This has led to an unsystematic placement of quasi-private conduct into one of the several theories falling under the doctrine. Instead of providing greater consistency, constitutional scholars largely agree that this approach has created far greater uncertainty. This Part will first highlight that uncertainty by showing the difficulty courts have in applying the state action doctrine to FINRA and other SROs. Next, it will go into greater detail regarding the functionalist expansion of the doctrine and the theories that currently fall under it.

A. An Inevitable Circuit Split

Given the various doctrinal difficulties underlying the state action doctrine, FINRA presents a difficult question left unanswered by the Supreme Court. Some lower courts have shirked the issue altogether. For example, in a 2011 decision involving a set of circumstances not unlike the Quattrone case above, the Eleventh Circuit acknowledged a circuit split on the issue but left the state actor status of FINRA undecided.

The Second Circuit, in Desiderio v. National Association of Securities Dealers, Inc., conducted a cursory analysis of whether NASD was a state actor, deeming it a private entity for the purposes of constitutional claims brought against it. The court cited a factor routinely relied upon in the state action analysis by finding that the “extensive and detailed state regulation” of a business entity does not convert that organization’s actions into those of the state.

27. See Developments in the Law, supra note 26, at 1255 (noting the struggle of some commentators to describe “the historical development and continued incoherence of the state action doctrine . . .”).
28. The Supreme Court has not yet taken on the issue of state action in the context of any self-regulatory organization.
30. 191 F.3d 198, 206 (2d Cir. 1999).
31. Id. (citing Jackson v. Metro. Edison Co., 419 U.S. 345, 350 (1974)). Jackson was a Supreme Court case involving the extensive regulation of a utility and concluding that such regulation alone is insufficient to find state action. However, three separate dissents were filed in the Jackson case, each proffering compelling arguments for finding state actor status of a heavily regulated utility enjoying a monopoly in the community. Justice Marshall’s dissent
Seventh Circuit, in Gold v. SEC, faced with the question of whether the NYSE—another SRO with powers similar to FINRA—is a state actor concluded that “heavy governmental regulation, by itself, does not make a private organization into a government actor.”

Otherwise, the court added, it “would bring under the Fifth Amendment much of the private sector, ranging from hospitals to railroads.”

The Tenth Circuit has simply assumed that the Due Process Clause applies to enforcement actions of the NASD, sidestepping the state action analysis altogether. Across a range of cases, courts have characterized SROs such as FINRA as purely private organizations, quasi-governmental organizations, or organizations engaged in purely governmental activity. These distinctions are important because constitutional claims against FINRA are either valid or invalid depending on which category the SRO falls into.

The state action doctrine continues to be a highly controversial standard for analyzing the proper relationship between private actors and the state. Scholarship on the subject has dwindled in recent years, in part due to frustration with the current state of affairs.

emphasized the operation of a utility as a service “uniquely public in nature” that should be treated as state action. Jackson, 419 U.S. at 366.

32. The conclusion itself was dicta as the matter had been deemed to be waived on appeal. See Gold v. SEC, 48 F.3d 987, 991 (7th Cir. 1995) (noting the court's doubt about comprehensive regulation of securities exchanges by the federal government turning exchanges into government actors).

33. See Gold v. SEC, 48 F.3d 987, 991 (7th Cir. 1995) (noting the court's doubt about comprehensive regulation of securities exchanges by the federal government turning exchanges into government actors).

34. Id. The court did not acknowledge fundamental differences between hospitals or railroads and a self-regulatory body that enjoyed a near-monopoly and extensive collaboration with federal agencies for engaging in purely regulatory enforcement activities.

35. See Handley Inv. Co. v. SEC, 354 F.2d 64, 66 (10th Cir. 1965) (holding the requirements of procedural due process were fully met with regard the application of the NASD rules); Rooms v. SEC, 444 F.3d 1208, 1214 (10th Cir. 2006) (finding that due process requirements apply to the NASD).


39. Developments in the Law, supra note 26, at 1250 (noting the "lull in scholarly engagement with the doctrine—perhaps out of sheer frustration . . ."). This Note attempts to temper any exaggerated claims of inconsistency by actually applying the various categories of
Some scholars who have ventured to analyze the doctrine pose various theories to explain its evolution (or lack thereof), relying on both formal and functional prescriptions. Other scholars have tried to find social, philosophical, and other theoretical explanations for the doctrine’s development.

As a result, the disarray in the state action doctrine today explains the inability of lower courts to apply it uniformly to SROs. Courts have failed to find a consistent formula for evaluating the enforcement actions of FINRA and, as a result, have refrained from engaging in anything but a perfunctory state action analysis. The mechanical inquiry of the current state action doctrine, involving the indiscriminate cherry picking of facts surrounding the challenged action and the theories related to the doctrine, often gives courts a degree of unworthy self-assurance. The next Section explains the historical development of the state action doctrine to clarify just how the current doctrinal inconsistencies became a reality.

B. A Rationale for the Doctrine

As early as 1883, the Supreme Court laid down the basic framework that has governed the state action doctrine ever since. In The Civil Rights Cases, Congress had enacted the Civil Rights Act of 1875 under the enforcement provision of the Fourteenth Amendment to bar racial discrimination by certain types of private individuals and organizations. The Court invalidated Congress’s application of the Fourteenth Amendment to private behavior by making a core
distinction between "state action" and "private action." This distinction rested not only on a textual understanding of the Fourteenth Amendment but also on the fundamental need to limit the reach of constitutional prohibitions into private conduct. Constructing a clear boundary between public and private conduct was an important goal for the Court because it prevents overenforcement of the Constitution in the private sphere.

The Civil Rights Cases were hardly the end of the matter as it became clear that the increasing incursions of the state into the private sphere would require a functionalist expansion of the doctrine from its formal beginnings. The thrust of this expansion took place in the latter half of the twentieth century, after the New Deal's administrative state had become firmly ensconced as a new and pervasive form of state involvement in private activity at both the federal and state level.

As a result, the Court began to engage in an increasingly fact-based analysis, defining the contours of the state action doctrine on a case-by-case basis. For example, in *Marsh v. Alabama*, the Court found that a privately owned town was a state actor because the "town" looked very much like a place that was traditionally administered by the government. Later, in *PruneYard Shopping Center v. Robins*, a privately owned mall was found not to be a state actor because, in comparison to the town in *Marsh*, the mall did not really engage in traditional public functions.

However, rather than developing a universal framework that would enable a court to determine, in binary terms, whether state action was present, the Court began to establish a number of imprecise and overlapping rationales to accommodate a wide range of constitutional claims and actors. Consequently, each new case

47. Id.
48. See John Dorsett Niles et al., *Making Sense of State Action*, 51 SANTA CLARA L. REV. 885, 886 (2011) (noting that the public-private distinction is what "fundamentally...defines the Constitution's reach").
49. With the exception of the 13th Amendment (since the 1960s), the provisions of the Bill of Rights and the Civil Rights Amendments have been understood to proscribe government conduct.
52. Niles et al., *supra* note 48, at 888.
55. Niles et al., *supra* note 48, at 886.
required courts to fit contemporary fact patterns into one of the increasingly blurry categories of prior precedent. This method resulted in a "jumbled" analytical framework that is quite unpredictable, despite the importance of the constitutional question.56 This history explains the current condition of the state action doctrine, an increasingly flexible (and thus arbitrary) determination that must be applied to new forms of quasi-private/quasi-public activities.57

The Supreme Court and constitutional scholars have attempted to classify the state action cases into three broad groupings. Understanding these categories and their underlying themes is an important first step to rebuilding a more unified state action doctrine and to determining the status of FINRA.

C. Three Categories of State Action

When evaluating a particular state action question, the Court often classifies the relevant conduct under one of three generally accepted categories: (i) the public function theory, (ii) the nexus theory, and (iii) the joint participation theory.58 It is important to note that these theories reflect not only the various types of private activity that have come before the Court, but also the distinct philosophies of the Supreme Court Justices.59

1. Public Function Theory

The public function approach asks whether the activity performed by the private party has been traditionally and exclusively governmental in nature.60 A private enterprise, carrying out something that is historically considered a public function, is more likely to be counted as a state actor.61 The Court limits what can be

56. Id.
57. See infra Part IV (providing an analysis of the Court's three approaches to the state action doctrine).
58. See Friedman, supra note 18, at 735 (explaining the different types of philosophies of the Justices as to what constitutes state action). Many commentators will only consider two categories—the public function theory and the nexus theory—while others have found another category through Brentwood Academy, titling it the "entwinement" theory.
59. See id. (explaining the Justices' different philosophies as to what constitutes state action); see also Glennon & Nowak, supra note 23, at 222 (detailing different state action philosophies).
61. Friedman, supra note 18, at 736.
considered a public function by imposing an exclusivity requirement.\textsuperscript{62} Thus, conduct that might ordinarily be \textit{perceived} as governmental in nature may not be state action if the Court can identify historical examples where private bodies have delivered the same service.\textsuperscript{63}

For example, in \textit{Jackson v. Metropolitan Edison Co.},\textsuperscript{64} a privately owned utility, licensed and regulated by the state, was held not to be performing a public function because at least some utilities had been \textit{private} in the past.\textsuperscript{65} The \textit{Jackson} Court also rejected the argument that substantial regulation by the state—a common feature of non-public utilities—was sufficient to characterize the activity as public in nature.\textsuperscript{66} Nevertheless, a dissent by Justice Marshall agreed that, while heavy regulation was not sufficient to find state action, the operation of a utility was "uniquely public in nature" because the state either inevitably provides the service or so substantially regulates it that the private entity has essentially "surrender[ed] many of the prerogatives normally associated with private enterprise."\textsuperscript{67} This nuanced tug-and-pull regarding what should constitute "public" is a common feature of this category of the state action doctrine.

Two other areas where the Court has applied the public function theory are the regulation of schools\textsuperscript{68} and the misappropriation of the electoral process.\textsuperscript{69} In \textit{National Collegiate Athletic Association v. Tarkanian}, the Court held that the NCAA was a private organization when it required the University of Nevada to

\begin{itemize}
  \item \textsuperscript{62} \textit{Jackson}, 419 U.S. at 352 (limiting the public function theory by adding an exclusivity requirement to the private activity in question); \textit{see also} Friedman, \textit{supra} note 18, at 736 (stating that the public function approach requires private party activity to be exclusively reserved to the states).
  \item \textsuperscript{63} It is unclear what degree of historical or contemporary private involvement is needed to be relevant to the analysis except that the \textit{Jackson} Court noted that the function must be traditionally and exclusively performed by the government. CHEMERINSKY, \textit{supra} note 20, at 532. Dissenting opinions often reject the rigidity of the exclusivity function if the public nature of the private activity seems to intuitively be the correct answer—either due to monopolies, heavy regulation, or the prevalence of government's historical involvement. \textit{See generally} Thomas G. Quinn, \textit{State Action: A Pathology and Proposed Cure}, 64 CALIF. L. REV. 146 (1976) (providing a detailed analysis of the state action theory).
  \item \textsuperscript{64} \textit{Jackson}, 419 U.S. at 354.
  \item \textsuperscript{65} \textit{Id.} at 353; \textit{see also} CHEMERINSKY, \textit{supra} note 20, at 531.
  \item \textsuperscript{66} \textit{Id.} at 366.
  \item \textsuperscript{67} \textit{Id.} at 372.
  \item \textsuperscript{68} \textit{See} CHEMERINSKY, \textit{supra} note 20, at 537 (detailing the Court's consideration of whether a private entity regulating schools is a public function). \textit{See generally} NCAA v. Tarkanian, 488 U.S. 179, 180–82 (1988) (holding that the NCAA did not have to provide due process before it suspended the basketball coach at a state university); Rendell-Baker v. Kohn, 457 U.S. 830, 843 (1982) (holding that there was no state action when a private school, which received a majority of its funding from the government, fired a teacher because of her speech).
  \item \textsuperscript{69} Terry v. Adams, 345 U.S. 461, 462–63 (1953).
\end{itemize}
suspend its basketball coach. The Court viewed the regulation of collegiate athletics as falling outside the “traditional ... [and] exclusive” function of the state. Moreover, in a subsequent case—Brentwood Academy v. Tennessee Secondary School Athletic Association—the Court referred back to Tarkanian and noted that any influence that a state school had on the NCAA was too diffuse, stressing that “NCAA policies were shaped not by the University of Nevada alone, but by several hundred member institutions, most of them having no connection with Nevada.”

In Terry v. Adams, the Jaybird Democratic Association, a private entity composed of registered Democrats, excluded African Americans from participating in its straw poll. The candidate chosen by the group nearly always won the official Democratic primary. The Jaybirds contended that they were a private club and therefore exempt from the complained constitutional violation. The Court disagreed, holding that the regulation and supervision of a public election were traditionally and exclusively the province of the government. Second, the Court took a functional approach by highlighting the monopoly-like control that the Jaybird poll had on the outcome of the public electoral process. The Jaybird poll had become “an integral part, indeed the only effective part, of the elective process.” Thus, the Court was willing to extend constitutional protections into the private sphere when the private activity misappropriated a characteristically public function.

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70. Tarkanian, 488 U.S. at 182.
71. Id. at 203 n.18. The Court relied on an earlier case, San Francisco Arts & Athletics, Inc. v. United States Olympic Committee, 483 U.S. 522, 545 (1987), which had declared that “neither the conduct nor the coordination of amateur sports has been a traditional government function.” CHEMERINSKY, supra note 20, at 537.
72. CHEMERINSKY, supra note 20, at 538. Unlike the Tarkanian case, in Brentwood, the Court did find state action of a state inter-school athletic association in part because the vast majority of its members were state schools and they all fell under one state jurisdiction.
73. Terry, 345 U.S. at 463.
74. Id.
75. CHEMERINSKY, supra note 20, at 536.
76. Id.
77. Id.
78. Id.
79. It is worth noting that evidence of intent by the state to shift the electoral process onto the private sphere in order to avoid constitutionally mandated integration of the primaries likely played a role in the outcome of Terry v. Adams. Id. The possibility of intent as yet another covert factor in state action analysis simply adds to the thrust of this Note’s argument.
2. Nexus Theory

The nexus theory requires "a sufficiently close nexus between the State and the challenged action of the regulated entity, so that the action of the latter may be fairly treated as that of the State itself." This theory focuses on the conduct of the government, rather than the type of private activity being challenged. Under the nexus theory, the Court looks to whether the government has authorized, significantly encouraged, or facilitated the private conduct. Analytically, the Court considers "points of contact" between the state and the private entity, finding state action when there is a high degree of involvement.

In Blum v. Yaretsky, a class of Medicaid patients claimed that decisions made by private nursing homes to transfer them to facilities offering less extensive services constituted state action. The litigants alleged that the government imposed pervasive funding requirements on the nursing homes, which caused the transfer decisions. For example, state policy required private medical facilities to create "utilization review committees" to determine the level of care needed for each patient. The state reserved the right to adjust funding if the review committee suggested transferring eligible patients to a less expensive facility and the facility refused. Given that over ninety percent of the patients were funded by Medicaid, a fairly strong argument could be made that the state's rules "significantly encouraged" the private nursing homes to transfer eligible patients. However, the Court held that because the review committees exercised some degree of medical discretion, the state's rules were not sufficient to label the nursing homes state actors.

Nevertheless, there are instances where regulations or licensing schemes can be so coercive that the regulated entities might
be viewed as state actors. In *Moose Lodge No. 107 v. Irvis*, the Lodge was a private club that restricted membership to whites.\(^89\) This racially restrictive policy was enshrined in the club's charter.\(^90\) An African American guest who was denied access contended that there was state action because the state had granted the Lodge a number of liquor licenses and thus endorsed the club's discrimination policy.\(^91\) The Court predictably held that mere state licensing is insufficient to find state action.\(^92\)

The Court did, however, strike down a provision of the licensing regulations that threatened to terminate a liquor license based on violations of an entity's charter provisions.\(^93\) The Lodge was willing to ignore its racially restrictive charter policy, but it feared losing its liquor license under the licensing regulation. Apparently, the Court was reluctant to go so far as to allow states to *force* parties to engage in racial discrimination. Hence, the Court created an exception to the state action doctrine in this narrow instance.\(^94\)

### 3. Joint Participation Theory

The final approach under the state action doctrine is the joint participation theory.\(^95\) This theory is arguably a variant of the nexus theory because it measures state involvement based on the extent to which the private party and the state have jointly participated in the questioned activity. Three prominent Supreme Court cases have applied the joint participation theory, albeit in different ways: *Lugar v. Edmonson*,\(^96\) *Burton v. Wilmington Parking Authority*,\(^97\) and *Brentwood Academy*.\(^98\)

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90. Id. at 179.
91. Id. at 163.
92. Id.
93. Id. at 163–64.
94. *Shelley v. Kraemer*, 334 U.S. 1, 13–14 (1948). *Shelley* is also often viewed as a narrow departure from finding judicial enforcement insufficient for state action since the private conduct in question involved a racially restrictive covenant and parties who were *willing* to break it but for the court's enforcement. *Id.*
95. Friedman, *supra* note 18, at 735–36. Many commentators have folded state action cases characterized as joint participation into a broader interpretation of the nexus theory.
97. *See Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 724 (1961) ("It cannot be doubted that the peculiar relationship of the restaurant to the parking facility in which it is located confers on each an incidental variety of mutual benefits.").
In *Lugar v. Edmonson*, the Court applied a two-part test for determining state action that asks: (i) whether there was a deprivation of a right or privilege created by the state, or a deprivation caused by a person for whom the state is responsible; and (ii) whether the party charged with the deprivation is a state actor "because he is a state official, because he has acted together with or has obtained significant aid from state officials, or because his conduct is otherwise chargeable to the State."99

Notwithstanding *Lugar's* two-part test, *Burton* is perhaps the most well-known case applying the joint participation theory.100 The case involved a government lease to a privately owned restaurant operating in a government-owned parking building.101 The restaurant's racially discriminatory policies, neither prohibited by the state nor barred by the lease, were challenged as unconstitutional.102 The Court concluded that state action was present by relying heavily on the fact that the state relied on income from the lease to successfully operate the parking building.103 Because of this "symbiotic relationship," the city had an affirmative obligation to include a non-discrimination clause in its lease with the private entity.104

Finally, the Court's 2001 *Brentwood Academy* decision broadened the joint participation theory, finding that a private entity in charge of regulating and supervising interscholastic athletics in Tennessee was a state actor based on the government's "entwinement" with its activities.105 Because the Court did not precisely define the contours of "entwinement" or the degree to which the state needs to be involved, the reach of the Court's decision remains unclear. The Court

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99. *See Lugar*, 457 U.S. at 923 (providing a formula for determining "fair attribution").

100. *See Burton*, 365 U.S. at 725 (holding that the exclusion of an individual solely based on race from a restaurant operated by a private owner under lease in a building financed by public funds and owned by the parking authority was discriminatory state action in violation of the Equal Protection Clause). *Id.* It should be noted that the categorization of *Burton* under "joint participation" is not a universal practice. Other commentators have placed the case under the public function approach (Chemerinsky, for example) or a separately identified "symbiotic" sub-category of the nexus theory. Indeed, an easily identified consensus does not exist with respect to much of the categories delineated in this Note, and many of the cases could overlap or blur into other categories. This observation merely strengthens claims against the viability of current state action doctrine. Nevertheless, care has been taken to track the categories above to as close to the median understanding in scholarship as is possible.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

justified its conclusion by simply emphasizing the relationship between the association and the government. Moreover, whether entwinement is a new variant of a preexisting theory remains unclear.

Before applying the Court's three state action theories to FINRA, it is crucial to understand SROs and their history of self-regulation. This understanding is important because several factors play a role in determining whether an entity is a state actor, including history, governance structures, public perception, congressional judgment, customary practices, and others.

III. THE FOUNDATIONS OF SELF-REGULATION

Self-regulation has been ubiquitous in the securities industry since brokers in New York formed the first organized stock market in 1792. Private conventions within the industry developed before federal securities laws were enacted in the 1930s, and many of the important concepts that were subsumed into federal law originated from self-regulation practices in the pre-Depression Era. Today, while a variety of public and private regulatory institutions preside over the national securities market, FINRA is the largest non-commercial self-regulatory authority in the United States. The Association regulates almost every securities broker-dealer in the industry, and most dealers are statutorily required to become FINRA members.

106. For example, eighty-four percent of its members were public schools; there was evidence that the state had traditionally delegated regulation of interscholastic athletics to the private entity; most of its funding was derived from member public schools; most of its meetings were held on government property; and the government appointed non-voting members of the private entity's committees. Id. Thus, the Court found significant government involvement without offering a standard through which the degree of involvement appropriate to find state action could be determined. Id. This is not surprising since a case-by-case analysis of whether state action is present will invariably result in a patchwork of criteria based on facts often too difficult to reconcile.


108. Karmel, supra note 36, at 3; see also SEC Concept Release Concerning Self-Regulation, supra note 107 (discussing the foundations of the self-regulatory system).

109. Such as privately operated national exchanges.


111. Securities and Exchange Act of 1934 § 15(b)(8), 15 U.S.C. § 78o (b)(8) (2012); see also Orenbach, supra note 110, at 136 ("FINRA regulates virtually every securities broker-dealer that conducts business in the United States, most of which are required by statute to be a FINRA member.")
statutory regulations, and the eventual establishment of FINRA as a consolidated self-regulatory entity.

The foundation for today's financial regulatory model is rooted in the failure of unfettered self-regulation during the Depression Era. Congress eventually recognized that rampant "manipulative and speculative" trading behavior was going largely unchecked. Initially, reform was targeted at the NYSE through the Securities Exchange Act of 1934. Rather than usurp the Exchange's well-established tradition of self-regulation, Congress reached a compromise, whereby a "structure of public governance" was statutorily imposed over the Exchange, transforming it from a private club to a government-supervised SRO. Under the supervision of the newly founded SEC, the federal government empowered the NYSE to employ its expertise in regulating the securities markets.

The public/private compromise of the Exchange Act emphasized a congressional commitment to self-regulation as the primary means of controlling the industry. Self-regulation was a "mutually beneficial balance" between the interests of the government and the industry. It was meant to achieve an efficient regulatory regime, combining the SROs' familiarity with the complexities of the industry with the SEC's ability to provide oversight and ensure overall compliance. Moreover, because member firms provided the funding for the SROs, the government could use its resources towards other regulatory initiatives.

In 1938, the Maloney Act provided a self-regulatory framework for the over-the-counter ("OTC") securities market by giving legal status to FINRA's precursor, the NASD—an already existing voluntary group of broker-dealers. During its initial history, the NASD remained largely "member-centric," in control of its own

112. Friedman, supra note 18, at 738-39.
113. Id.
114. Id.
115. Id.
116. Id. The authority included the power to regulate, subpoena, and call certain members for hearings.
117. Id. at 740.
118. Id. at 741.
119. SEC Concept Release Concerning Self-Regulation, supra note 107.
120. The private alternative to the public market exchanges regulated by the Exchange Act.
121. The existing group of broker dealers formed a private organization, the Investment Banker's Conference. STEVEN LOFCHIE & MOISES MESSULAN, CADWALADER WICKERSHAM & TAFT, SECURITIES SELF-REGULATORY ORGANIZATIONS (2008) (on file with author).
governance, and dedicated to the interests of the industry.\textsuperscript{122} The Maloney Act made membership voluntary and incentive-based.\textsuperscript{123} However, in 1975, amendments tightened the SEC’s control over the NASD and other SROs.\textsuperscript{124} The amendments also reaffirmed a preference for the self-regulatory model, emphasizing “the sheer ineffectiveness of attempting to assure [regulation] directly through the government on a wide scale.”\textsuperscript{125}

The most invasive function of the 1975 amendments was the grant of authority to the SEC to modify NASD rules as it deemed necessary and to require the NASD to adopt any rule issued by the SEC.\textsuperscript{126} The amendments also required SEC approval before any new SRO rules could issue.\textsuperscript{127} Finally, the SEC was given the power to oversee the governance structure of the NASD, and the amendments required that a broad swath of stakeholders be represented.\textsuperscript{128}

At this point, compulsory membership was not a feature of the SRO model. However, Congress eventually became frustrated with broker-dealers who were avoiding self-regulation by refusing to join the NASD, so it amended the Maloney Act in 1983 to impose compulsory SRO membership.\textsuperscript{129} This membership mandate seemed inevitable given the government’s prerogative to regulate all corners of the industry through the SRO model.

Finally, in the event that an SRO does not comply with the Exchange Act or its amendments, the SEC has the power to impose sanctions.\textsuperscript{130} Additionally, the SEC can discipline SRO members directly and commence injunction proceedings for unlawful trading practices.\textsuperscript{131} The amendments have had the effect of greatly

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\textsuperscript{122} Orenbach, \textit{supra} note 110, at 139. As early as the 1950s, instances of investor speculation, fraud, and manipulation occurred with “disturbing frequency” on stock exchanges and the OTC markets. In 1963, the SEC conducted a comprehensive study of the exchange and OTC markets. It identified lapses in SRO monitoring of those markets and the failure to produce appropriate standards of conduct. \textit{Id.} at 145.

\textsuperscript{123} Lofchie & Messulan, \textit{supra} note 121.

\textsuperscript{124} \textit{Id.}

\textsuperscript{125} SEC \textit{Concept Release Concerning Self-Regulation}, \textit{supra} note 107; \textit{see also} S. REP. No. 94-75, at 7 (1975) (“Because of the unique system of self-regulation in the securities industry, the principal markets for securities, i.e., the exchanges, are also the principal regulators of the activities of broker-dealers using those markets.”).

\textsuperscript{126} Friedman, \textit{supra} note 18, at 742.

\textsuperscript{127} \textit{Id.}

\textsuperscript{128} LOFCHIE & MESSULAN, \textit{supra} note 121.

\textsuperscript{129} \textit{Id.}

\textsuperscript{130} Thus, through the sanction power, the SEC is able to compel an SRO to take action in compliance with the Exchange Act without any recourse on behalf of the SRO. Friedman, \textit{supra} note 18, at 743.

\textsuperscript{131} \textit{Id.} at 744.
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broadening the Commission's authority over the NASD (and now FINRA).

In 2007, the SEC approved a plan to consolidate the NASD and the regulatory arm of the NYSE in order to synchronize regulatory rules between the two SROs. FINRA, the resulting organization, adopts rules; makes policy pronouncements; examines firms for compliance; and monitors members' financial solvency, operational capabilities, and risk assessment practices. FINRA also has an enforcement arm that investigates members for potential violations of securities laws and can bring disciplinary proceedings against alleged violators.

IV. AN APPLICATION OF THE THREE THEORIES

Some courts have confidently asserted that FINRA cannot be a state actor under the current doctrine. But it is unclear why that might be the case. As noted above, the state actor status of a private entity is largely uncertain unless the Supreme Court has heard a case with similar factual circumstances. Even then, similarity is often in the eye of the beholder, and points of contact that are significant in one case have been irrelevant in another. Analogous reasoning—an inevitable feature of constitutional analysis but an especially problematic device for state action issues—leads to uncertainty in the doctrine. This Part attempts to reveal the arbitrariness of the current state action doctrine. Specifically, an application of the three major theories to FINRA reveals the doctrine's weaknesses by showing that this SRO could reasonably be considered a private entity or a state actor under existing precedent.

A. FINRA Under the Public Function Theory

Under the public function approach, FINRA's state actor status depends on whether its regulatory functions are traditionally and exclusively governmental. Here, a court could rely on the century-long

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132. Lofchie & Messulan, supra note 121.


134. As a result of the incoherence, commentators have argued for doing away with the state action threshold and simply determining whether state action is present based on the merits of the case. Given the unlikelihood of adoption, this Note will not address that possibility.
history of self-regulation to conclude that SROs, like FINRA, do not engage in an *exclusively* public activity.

However, such a conclusion would be a superficial application of the public function theory. Certainly any foray into the history of securities regulation should not overlook the transformation that occurred in the post-War period. An entirely new paradigm has evolved over the decades, one which Congress and the SEC have deliberately constructed in response to the apparent failures of unfettered self-regulation. Transformative leaps in the relationship between the government and NASD/FINRA have been accompanied by congressional declarations affirming the unique public necessity of securities regulation. The justification for heightened state involvement in SROs was largely based on the public importance of the industry. That justification has become an ever more popular rationale among lawmakers in the aftermath of the 2008 financial crisis. Moreover, while federal involvement might only be a post–Depression Era occurrence, state laws have regulated the industry since its inception.

The regulatory constraints applied to member firms illustrate the importance of regulating the securities market. Members must submit themselves to FINRA’s rules and procedures in order to operate in the industry. Additionally, the powers bestowed upon FINRA have a distinctly governmental character. The organization can promulgate generally applicable rules, investigate alleged violations, levy fines, and even ban members from the industry. As highlighted in the Quattrone case, FINRA looks very much like a government actor when it exercises these statutory powers.

The courts and commentators who contend that FINRA is not a state actor have applied the existing public-function cases without fully appreciating the unique status of this organization. Utilities like the one challenged in *Jackson*, for example, primarily provide a *service*. Their regulatory activities—such as setting prices—are secondary to that service component. In other words, unlike FINRA

135. SEC Concept Release Concerning Self-Regulation, *supra* note 107; *see also* S. Rep. No. 94-75 (1975) (suggesting that Congress is aware of the public necessity of securities regulation).


137. SEC Concept Release Concerning Self-Regulation, *supra* note 107 ("In its earliest years, the nascent U.S. securities market was loosely subject to state laws . . . .").

138. *See supra* note 111 (suggesting that the importance of securities regulation is demonstrated by membership requirements and regulations of FINRA members).

139. *See supra* Part I (describing the general authority conveyed to FINRA).
and the securities market, the state in *Jackson* had not constructed an overarching scheme of regulation for the utilities market with several specific statutes.

Indeed, FINRA’s activities could reasonably be analogized to the Jaybird Democratic Association in *Terry v. Adams*. There, the Court’s reliance on the public importance of the electoral process allowed it to extend state action to a private organization despite very weak evidence of state involvement. The Court viewed the electoral process as a standard government function.\(^\text{140}\) Consequently, it was irrelevant that the state’s ability to control the Jaybird Association, a private political organization, was limited.\(^\text{141}\) Similarly, the regulation of financial markets, as evidenced by the complex regulatory framework and congressional demands for a public role, can be perceived as an exclusively governmental prerogative. Hence, the mere fact that Congress delegated the regulatory mechanism to a private entity like FINRA does not mean there is no longer state action.\(^\text{142}\) The history of private self-regulation is overcome by the federal government’s interest and heavy involvement in regulating the securities industry since the Depression.

Nevertheless, many commentators have narrowly construed *Terry v. Adams*, emphasizing the public nature of the electoral process and the fact that the state appeared to be delegating away its regulatory authority in order to enable discrimination.\(^\text{143}\) As such, courts have sometimes relied on the government’s *intent* as a covert rationale for finding state actor status.\(^\text{144}\) Yet, even under this limited construction of *Terry*, history shows that the government’s *intent*

\(^\text{140. CHEMERINSKY, supra note 20, at 532.}\)

\(^\text{141. Id. at 536. It is worth noting that the Court in *Terry* characterized the Jaybird’s activities as inappropriate state delegation of the electoral process. However, in other cases, the Court has strictly construed the delegation doctrine, so that any discretion on the part of the private actor will be enough to nullify the delegation theory. In this case, the Court apparently viewed the importance of the electoral process as a public function to be outweighed by any amount of discretion available to the private actor.}\)

\(^\text{142. Certainly the relevant history of NASD/FINRA is one that is characterized by significant government “guidance” and exploitation of the benefits of the SRO model. The form of “cooperative regulation,” termed by the SEC’s first chairman, Joseph Kennedy, had the advantage of allowing for a less invasive regulation of the industry and permitted a quicker response to perceived violations than would be possible by a government agency constrained by due process. SEC Concept Release Concerning Self-Regulation, supra note 107.}\)

\(^\text{143. CHEMERINSKY, supra note 20, at 537 (showing that a narrow reading of the White Primary Cases is the most reasonable construction, and showing the court’s willingness to engage in functional arguments when there is evidence of intent by the state to delegate state functions to avoid constitutional limitations).}\)

\(^\text{144. Id. at 532 (arguing that whether the state intended to delegate the governmental activity precisely to allow constitutional violations is one way of trying to make sense of the public function theory).}\)
behind the adoption of the self-regulatory model for the securities industry was, in part, to avoid constitutional constraints that would inevitably attach to direct regulation. As articulated by former SEC Chairman William Douglas, self-regulation, combined with close supervision by a government agency, allowed the government to take swift enforcement actions against member firms without the restraints of due process. Thus, the government’s intentions with FINRA are highly analogous to the regulatory dynamics in Terry v. Adams.

**B. FINRA Under the Nexus Theory**

The nexus theory portends even greater uncertainty for a court trying to place FINRA on either side of the state action divide. In Blum v. Yaretsky, for example, the Court made it clear that extensive regulation of the private entity does not itself confer state actor status. There, the presence of a nexus between the state and the private entity was mitigated by some level of discretion available to the nursing home, discretion that the Court characterized as “independent medical judgment.”

It is unclear how much discretion or what type of discretion would be enough under Blum, but, whatever the standard, FINRA is likely a private actor under the nexus theory. The very purpose of the self-regulatory model that Congress and the SEC adopted is to utilize the benefits of SRO discretion. Discretion is an inherent feature of the self-regulatory model, which the government actively sought in order to free up government resources and utilize SRO expertise.


146. See Blum v. Yaretsky, 457 U.S. 991, 1008–09 (1982) (suggesting that although an entity acts under the “color of state law,” this assignment entails functions and obligations in no way dependent on state authority . . . [not] dictated by any rule of conduct imposed by the State”); see also supra text accompanying notes 83–88 (suggesting that the court acted to affirm the nexus theory).

147. 457 U.S. at 1014. The argument that significant regulation alone is not enough, even when funding for the private entity is conditioned on the framework of government criteria, is belied by other cases where partial state government assistance to segregated private schools in Norwood v. Harrison, 413 U.S. 455 (1973), and Gilmore v. City of Montgomery, 417 U.S. 556 (1974), was sufficient to attach state actor status to those schools. See Chemerinsky, supra note 20, at 549 (suggesting that Norwood and Gilmore can be distinguished on the ground that the government gave aid with the intent of undermining school desegregation).

148. William Douglas, Chairman of the SEC, said of the SRO model when the Maloney Act was being considered in 1938 that “[g]overnment would keep the shotgun . . . behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used.” Seligman, supra note 145, at 1361.
Hence, neither the extent of statutory regulation nor the SEC’s active role in FINRA activities would be sufficient to deem it a state actor under the nexus theory.

However, like the public function theory, the nexus theory can also be manipulated to arrive at different results. In *Moose Lodge*, the Court invalidated a provision of state law that effectively coerced two unwilling parties into violating the Constitution. The statute in question would terminate a private club’s liquor license if it violated any provision of its own charter. The lodge wanted to ignore its racially restrictive policy but was strongly discouraged from doing so by the regulation. The state’s regulation in *Moose Lodge*—a generally applicable conditional liquor license—was arguably less intrusive than the detailed regulations in *Blum*. Hence, it is reasonable to conclude that it was the coercive nature of the regulation that altered the Court’s usual approach under the nexus theory.

Similarly, FINRA could also fit under the “coercion” rationale of *Moose Lodge* because it has a fundamentally coercive relationship with its members. By statute, members must abide by the enforcement proceedings that FINRA brings in order to operate in the industry. The sanctions imposed on Frank Quattrone—a $30,000 fine, one year suspension, and the threat of permanent suspension from the industry—highlight FINRA’s coercive power. Moreover, FINRA’s activities are mandated by statute and heavily guided by the SEC. Even though FINRA may possess day-to-day discretionar

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149. *See supra* text accompanying notes 89–94 (providing support from *Moose Lodge* No. 107 *v. Iris* and *Shelley v. Kraemer*).

150. *See supra* text accompanying notes 89–94.

151. *See supra* text accompanying notes 89–94.

152. In *Blum*, the regulations were a more direct product of the state’s interest in adjusting its Medicaid funding to nursing facilities. They called for the use of “utilization review committees,” the production of reports to the state for approval, and the power to adjust the state’s Medicaid funding to the nursing facilities. While this Note will later argue that these facts alone may not be enough to prove the state’s “material interest,” they should be enough to show that, compared to *Moose Lodge*, there is greater involvement by the state in *Blum*. *See supra* text accompanying notes 89–88; *see also infra* text accompanying notes 193–96.

153. Along with the discriminatory characteristic of the constitutional violation.

154. Again, it should be emphasized that the Court never actually develops a separate “coercion” theory, but it is clear from the case that the presence of unwilling parties, much as was the case in *Shelly v. Kraemer*, plays a role in invalidating the regulatory provision.


156. The appeals process, which gives significant discretion to the SRO and the SEC, is also irrelevant because the constitutional protection claimed by the plaintiff is itself dependent on state actor status, trapping the FINRA member into a circular analytical framework.

157. *See supra* note 111.
power, the government retains overarching authority, which presents a much stronger rationale for state action.

Further illustrating the wide analytical latitude that the nexus theory provides, many courts focus on the particular activity being challenged rather than the overall relationship between the private entity and the state. Courts do this because the Supreme Court has given no definitive guidance about what level of generality to use when applying the state action doctrine. In Desidierio v. National Association of Securities Dealer, Inc., for example, the Second Circuit engaged in a cursory high-level analysis of the state actor status of the NASD as an entity, relying on formal conditions such as its private incorporation and the fact that it received no state or federal funding. In a brief sentence, it simply cited the Supreme Court’s refrain in Jackson that extensive regulation does not convert a private organization into the state. Nevertheless, the Second Circuit also analyzed the specific conduct of which the plaintiff complained. The complaint alleged that a mandatory arbitration clause contained in a NASD document unconstitutionally required the plaintiff to forfeit her Fifth Amendment right to due process. Without ruling on the matter, the Second Circuit applied the nexus theory to the relationship between the state and the arbitration clause, as opposed to the relationship between the state and the NASD. Thus, because of the absence of meaningful Supreme Court guidance, the court in this instance considered the organization as a whole as well as the specific violation to determine whether a sufficient nexus was present.

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158. Which is evidenced by the ease with which it had encroached itself into NASD and FINRA on a regular basis.
159. Moreover, even this discretionary activity is ultimately reviewable by the SEC, which has the power to alter on its own will. FINRA may even be required to implement rules promulgated at the SEC without any meaningful ability to frustrate the agency intrusion. SEC Concept Release Concerning Self-Regulation, supra note 107.
160. 191 F.3d 198, 206 (2d Cir. 1999).
161. Id.
162. Id.
163. Id. at 206–07. The court cited Blum v. Yaretsky, stating that the case “requires a nexus between the state and the specific conduct of which [the] plaintiff complains.” Id.
164. Id.
165. Id. The Court noted that no SEC rule encouraged the promulgation of the mandatory arbitration clause, and the requirement that the SEC approve the rule prior to implementation was not enough to find state action. Id. Had the SEC encouraged the NASD to promulgate the mandatory arbitration clause, the Second Circuit may have found that state action was present.
C. FINRA Under the Joint Participation Theory

As explained above, the joint participation theory is grounded in the two-part test from Lugar. Under a narrow reading of that test, the first prong can only be met when the rule in question is promulgated by the government and has the force of law. The second prong can only be met when the state is directly involved in enforcing that law. Moreover, both prongs suggest that courts should examine the specific conduct being challenged, not the overall relationship between the state and the private entity. With FINRA, the first prong arguably cannot be satisfied since the rules that regulate the securities market are formally promulgated and implemented by FINRA, not the SEC. Moreover, the language of the second prong remains vague enough to satisfy either side of the state action divide, and the relevant analysis would mirror the arguments made under the public function theory.

Nevertheless, Burton v. Wilmington Parking Authority may provide support for finding that FINRA is a state actor. There, the state had "so far insinuated itself into a position of interdependence with [the private entity] that it must be recognized as a joint participant." The two key factors for finding state action in Burton were (i) the financial benefits that the state was receiving from its lease with the restaurant and (ii) the discretion that the city exercised in choosing the provisions of the lease, which did not prohibit racial discrimination. Both factors are necessary for a finding of joint participation under Burton. For example, if the second factor alone was sufficient, almost any private entity licensed by the state would be deemed a state actor, a possibility already rejected by the Supreme Court.

166. Recall that the two-part test requires: (i) a deprivation caused by the exercise of a right or privilege created by the state or a rule of conduct imposed by the state, or a person for whom the state is responsible; and (ii) the party charged with the deprivation to be a person who may be fairly said to be a state actor "because he is a state official, because he has acted together with or has obtained significant aid from state officials, or because his conduct is otherwise chargeable to the State." Lugar v. Edmondson Oil Co., 457 U.S. 922, 923 (1982).

167. CHEMERINSKY, supra note 20, at 542.

168. Id.


170. CHEMERINSKY, supra note 20, at 544–45.

171. See id. (providing further analysis of the Burton v. Wilmington Parking Authority decision).

172. See id. Moreover, in Jackson v. Metropolitan Edison Co. a licensing requirement alone was not enough to find state action.
Under Burton, a reasonable argument could be made that the federal government has so far inserted itself into the securities industry that it must be recognized as a joint participant with FINRA. A symbiotic relationship between the state and FINRA can be found on multiple levels. For example, the federal government's deficiencies in resources and knowledge were a primary rationale for using the SRO model to regulate the industry when the Maloney Amendment was enacted in 1938.\textsuperscript{173} Even after SRO failures prompted the 1975 Amendments, Congress stuck with the self-regulatory model (under the strict supervision of the SEC) to harness the resources and expertise of the industry.\textsuperscript{174} Moreover, members of FINRA are required by statute to fund the SRO, providing further evidence that the government financially benefits from this private entity.\textsuperscript{175}

This symbiotic relationship continues today. In 2003, the NASD and NYSE had a collective regulatory staff of 2,650 and a regulatory budget of $642 million.\textsuperscript{176} The number of staff members at both SROs was over four times the number in the SEC's Division of Market Regulation, the branch responsible for overseeing all securities regulations.\textsuperscript{177} The SEC could not directly supervise the industry without significant added costs. Therefore, depending on how broadly the Burton case is construed, a court could certainly find that FINRA is a state actor under the joint participation theory, given its strong symbiotic relationship with the federal government.

Finally, even if Burton is construed narrowly,\textsuperscript{178} the Court's language in Brentwood Academy leaves open the possibility that a court could find that there is sufficient "entwinement" between FINRA and the SEC to constitute state action.\textsuperscript{179} The Court used no real formal standard in Brentwood Academy to determine what may or may not constitute entwinement. However, a number of factors suggest that the intensity of state involvement in Brentwood Academy was much weaker than the level of control that the SEC has over FINRA. For example, in Brentwood Academy, the state's influence primarily came from the fact that public high schools comprised a

\textsuperscript{173} Seligman, supra note 145, at 1361.
\textsuperscript{174} SEC Concept Release Concerning Self-Regulation, supra note 107.
\textsuperscript{175} Id.
\textsuperscript{176} Seligman, supra note 145, at 1384.
\textsuperscript{177} Id.
\textsuperscript{178} CHEMERINSKY, supra note 20, at 544--45 (showing that Burton's rationale has not been construed broadly).
\textsuperscript{179} Justice Souter noted that there was no single test for determining state action, but said that the "facts in this case justified concluding that there was sufficient government 'entwinement' for the Constitution to apply." Id. at 538.
majority of the association's membership. Additional factors suggesting entwinement included the indirect funding of the organization by public schools and the use of public facilities for organizational meetings.\textsuperscript{180} There was no other direct involvement from the state government aside from a Tennessee statute that recognized the role of the athletic association.\textsuperscript{181} By almost every measure, the federal government is much more entwined in the affairs of FINRA than Tennessee was with the athletic association in Brentwood Academy. For example, the SEC has a direct, top-down relationship with FINRA, not the diffuse, member-centric one at issue in Brentwood. FINRA's funding may not directly come from the state, but federal law calls for funding to flow from FINRA's private members. Finally, unlike the limited legislative interaction in Brentwood, FINRA is a byproduct of multiple legislative commitments to the SRO model.

By now, it should be clear that the current state action doctrine should be replaced. The next Part will introduce a new way of evaluating the state actor status of quasi-private entities such as FINRA.

V. REBUILDING THE STATE ACTION DOCTRINE

A proper framework for analyzing state action must be grounded in the rationales for creating a public/private distinction in the first place.\textsuperscript{182} The main tension in the development of the state action doctrine has always been the formal need to maintain a bright line and the functional desire for a flexible approach that can be applied to a variety of fact patterns.\textsuperscript{183} This tension has become increasingly severe as the line between public and private activity continues to blur after the Civil Rights Cases.\textsuperscript{184} Nowhere is this blurring more evident than in the relationship between the federal government and FINRA. The informal ways in which the government can influence or coerce private entities suggest that the state action doctrine will always exhibit some degree of inconsistency.

\textsuperscript{181} Id. at 292–93.
\textsuperscript{182} See supra text accompanying notes 45–49 (explaining that the public/private distinction has been integral to the state action doctrine since its creation).
\textsuperscript{183} See supra text accompanying notes 45–49 (suggesting that, since the public/private distinction guards against extending constitutional prohibitions into the private sphere, this distinction must be adaptable to varying situations).
\textsuperscript{184} See supra note 26 (citing authorities that discuss this blurring).
Nevertheless, the doctrine as it currently stands creates untenable regulatory uncertainty for private parties. This Part presents a universal framework that squarely confronts the most common problem under the current state action doctrine: degree. The public function, nexus, and joint participation theories have failed to indicate how much activity should be public or how many points of contact should exist between the state and the private entity. By employing a methodology that explicitly focuses on degree, courts could better constrain themselves in their state action analyses.

A. A Two-Pronged Test

The new framework developed in this Note is meant to incorporate a semi-formal/semi-functional approach to state action that mitigates abuses of the private/public distinction while still maintaining a meaningful separation between the two types of activities. In order to achieve this goal, a court should ask two key questions: (i) Is the evidence of the state's but-for material interest in the private entity sufficient to characterize the private conduct as state action? (ii) Is the state's level of control over the injured claimant sufficient to characterize the private conduct as state action? At a basic level, most versions of the state action doctrine already consider both the government's degree of material interest—financial or otherwise—and its level of control over the defendant.

The first prong of this proposed test asks whether, but for the quasi-private entity, the state would step in to provide the service or activity in question. As explained further below, this is one of the functional concerns underlying the state action doctrine: a fear that the state may be able to sidestep constitutional constraints by delegating state activity to a private entity. The three theories described above attempt, albeit poorly, to define state activity in order to prevent this technical means of escape. However, as will be highlighted later, a but-for material interest inquiry has a more coherent connection to the goals of the state action doctrine.

The second prong of the proposed framework focuses on control and thus will serve as a backstop to any deficiencies in the material interest prong. As a result, the two criteria are disjunctive. Control is a functional expression of the doctrine, illustrated in cases such as

185. Delegation of purely state activity, as was the case in *Terry v. Adams*, is a good example.
Moose Lodge. 186 The state's pervasive involvement with a private entity—namely through regulation—may not satisfy a but-for inquiry, but it nevertheless could significantly constrain the private entity in question. The Court, faced with semi-private cases of racial discrimination soon after the Second World War, concluded that it needed to expand constitutional protections in these ambiguous circumstances. 187 Hence, the control prong of the framework advocated here recognizes that the government can play a constitutionally meaningful role in the private sphere even when it would not replace the private entity in its absence.

It is worth noting here that the framework posited in this Note does not question the normative underpinnings of the state action doctrine. Rather, it consolidates the categories and subcategories of the current doctrine into a more consistent analysis by focusing on the formal/functional tension that created those categories in the first place.

B. What Degree of Material Interest?

The state action doctrine is essentially a question of degree. Therefore, courts need a clear evidentiary standard to guide their analysis in determining how much material interest or how much control is sufficient to constitute state action. This is important because, as highlighted in the previous Part, there is almost always some degree of involvement between the state and the private entity. Consequently, a litigant could reasonably dispute the presence or absence of a material interest or control in any given case.

To determine whether the interest of the state in the private entity is but-for material, a court should consider whether the state’s desired goal is being advanced through the private entity or whether the state’s involvement is a predominantly clerical decision disconnected from an overarching objective. This question more precisely focuses on whether a but-for material interest is present, and hence, it is a better analytical approach to the state action inquiry.

186. In Moose Lodge, while it is reasonable to conclude that the state did not have a “material” interest in issuing a liquor license to the lodge, the Court did invalidate a regulatory provision that essentially controlled the private parties in their ability to allow non-white guests. Supra text accompanying notes 89–94. It is also worth noting Shelly v. Kramer, where arguably, the unstated rationale for the Court’s finding of state action was based on the state’s role in effectively coercing or “controlling” private entities to be bound by a privately drawn restrictive covenant because of the possibility of enforcement by the courts. See supra note 94.

187. See Developments in the Law, supra note 26, at 1258 (discussing “judicial manipulation” of the doctrine as a result of concern that the formalist approach failed to address “troubling instances of racial discrimination”).
For example, under the public function theory, a court must ask whether an activity falls into the amorphous and ex post concept of a "traditionally public" activity. The public function theory does not consider ways in which the domains of public and private entities can evolve and eventually overlap; moreover, the theory focuses on generalized activities disconnected from the case at hand. The Court analyzed the utilities in *Jackson*, for example, by looking into the history of utilities in the United States—a generalized inquiry that may not reflect the relationship between the state and a utility company in a particular case. The but-for material interest prong, in contrast, requires evidence of either a targeted approach or a clerical decision in the *case at hand*. This mitigates a court’s ability to cherry-pick historical facts to construct a “public function” narrative for or against state action.188

To illustrate the difference, consider the Court’s application of the public function theory in *Rendell-Baker v. Kohn*, where a private school that provided specialized education for troubled students was almost entirely funded by the state and was the only one of its kind in the school district.189 The funding was clearly aimed at a specific public service provided by state statute.190 Hence, a private entity was being used to advance a targeted public goal, which the school district was unable or unwilling to offer itself.191 Yet despite the state’s material interest in the school, the Court applied the formalistic public function test and merely relied on the fact that the “function performed [by the school] was not . . . ‘traditionally the exclusive prerogative of the State.’”192 The Court overlooked pertinent facts about the school’s relationship with the state and left it free to accomplish a legislative policy without any constitutional constraints. As noted above, the potential for this kind of abuse was precisely one

188. *See, e.g.*, supra text accompanying notes 66–67.


190. *Id.* (“When students are referred to the school by Brookline or Boston under Chapter 766 of the Massachusetts Acts of 1972, the School Committees in those cities pay for the students’ education.”).

191. To highlight just how unfocused the analysis can be from the underlying formal rationale for state action, the Court in *Rendell-Baker* admits that the education of “maladjusted high school students is a public function” based on the state statute, but then summarily goes on to conclude that because the state had not “until recently” provided the educational service, the legislative policy alone does not make those services “the exclusive province of the State.” *Id.* at 842. Apart from the possible flaw in the logic of this argument, the Court fails to recognize that previous ignorance of the legislative policy does not speak to whether the state may now be sidestepping the constitutional risks—and its attendant costs—by simply delegating the matter to a private entity. It is just this kind of potential for abuse that expanded the formal doctrine into its functional categories in the first place.

192. *Id.* at 842 (emphasis added).
of the underlying concerns of the state action doctrine as it evolved in
the twentieth century.

Similarly, the nexus theory looks into the degree of the state's
involvement with the private activity. However, while the nexus
theory is more specific than the public function theory, it remains
unclear what degree of involvement is sufficient to constitute state
action. To clarify, the nexus theory is incomplete because it does not
identify a threshold where involvement becomes so extensive that it
amounts to state action. The but-for material interest prong of the
standard set forth here draws such a line: it distinguishes targeted
goals from mere clerical decisions.

To illustrate this principle in a case relying on the nexus
theory, consider Blum v. Yaretsky. There, a private nursing home
received state funding for the costs of its facilities and the medical
expenses of ninety percent of its patients, and it faced penalties under
a regulation that sanctioned health care providers who offered
services “in excess of the beneficiary's needs.” This scenario
certainly seems to constitute a high level of state involvement, even if
the nursing homes retained some degree of medical judgment.

The but-for material interest prong would drill further down
into the real relationship between the state and the nursing home.
The state rules that determine the nursing home's funding could be
viewed as either a targeted goal or a clerical measure, depending on
the available evidence. For example, did the state enact the funding
rules as part of a statutory goal to provide nursing home services in
the state, or was it simply a clerical measure with little evidence that
the state would provide the services through some other avenue in the
absence of private compliance? Under this framework, the Court could
rely on the same factors it used to find the lack of a sufficient nexus
between the state and the nursing home: for example, no statute
required the state to facilitate nursing home services, the regulations
were categorized as mere reporting requirements, the rules did not
give the state the authority to directly alter the nursing home's
medical judgments, and state officials merely “review[ed]” nursing
home reports to ensure proper levels of funding. These factors
strongly indicate that the state has no but-for material interest in the
services provided by the nursing home, and hence it was unlikely that

194. See supra text accompanying notes 83–88.
195. The Court evaluates state action under all three categories but uses factors that could
arguably be analyzed in any one of them. Blum, 457 U.S. at 1005–12.
196. Id.
the state was formally abusing its constitutional obligations by delegating to the private sphere. Although the conclusion is the same, arriving at it through a single framework that emphasizes the normative underpinnings of the state action doctrine offers a better approach than the haphazard, fact-based standard that the Court used in *Blum*.

Cases like *Jackson* would also come out the same way under the framework proposed here. In *Jackson*, the Court highlighted factors such as the absence of state investigation of the activity in question, the mere approval of a practice initiated by the utility itself, and the prevalence of the state's approval authority for even uncontroversial activities. These factors show that the state in *Jackson* likely did not have a but-for material interest in the private utilities in question. Consequently, it is worth noting that the material interest prong does not require courts to evaluate any information that they do not already consider.

The but-for material interest prong is likewise superior to the symbiotic relationship rationale under the joint participation theory. The state and a private entity may often mutually benefit, financially or otherwise, from state involvement. But that benefit may or may not be incidental. The joint participation theory does not inform a court whether the state is abusing its constitutional duties by delegating an activity to a private entity instead of carrying it out on its own. Under the material interest prong, a court would look to whether, if this private activity did not exist, the state would find alternative means of acquiring the same benefits. In *Burton*, for example, the Court would have looked for evidence showing that the state's leasing program was essential to financing adequate parking facilities in the city of Wilmington.

**C. What Degree of Control?**

The second prong of the proposed test asks what degree of control must be exercised by the state to constitute state action. The court's analysis under this control prong should be based on whether the claimant can exercise significant choice. By focusing on choice, this prong attempts to place a meaningful limitation on the functional aspect of the state action doctrine, which, as noted earlier, reflects a

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198. *See supra* text accompanying notes 100–04.
199. Language in *Burton* suggests that this indeed might have been the case. Hence, again, much of the evidentiary standards required for this prong is already evaluated by the courts, albeit haphazardly. *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 717–18 (1961).
concern with governmental regulation occurring under the guise of private action (particularly during the Civil Rights Era). The focus on choice recognizes, as the courts have, that not all deprivations are constitutional deprivations.

Choice is a common, albeit not universal, difference between an individual’s experiences with the state versus a private entity. For example, when a private entity engages in discriminatory conduct, the injured party usually has meaningful alternatives available (e.g., eating at a non-discriminatory restaurant). However, when an individual is dealing with the state—applying for social security benefits, for instance—there is often no other recourse available. Thus, in most cases, the presence of a meaningful choice for the claimant to avoid constitutional injury by a quasi-private entity should serve as evidence that significant control—and thus state action—is present.

In Rendell-Baker, the Court would apply this second prong by focusing on the school’s control over the dismissed teachers. It would look to evidence showing that the relationship between the plaintiffs and the quasi-private entity significantly limited the plaintiffs’ ability to seek alternative means of redress—in this case, finding new employment. While the facts on this point are unclear from the Court’s opinion, it is unlikely that the claimants were so constrained in their employment options that they lacked a meaningful choice.

Employees of quasi-private entities are not state employees, and they typically have employment alternatives available. This stands in contrast to the electoral process in Terry v. Adams, an activity where the state has a monopoly—just the type of state imprimatur that the Court has long considered state action.

Finally, Brentwood Academy would have also been decided the same way under the control prong of the framework proposed here. There was probably evidence showing that the athletic association was so pervasive that a school had to be a member to remain a competitive choice for parents and students. Thus, the presence of this degree of state control would have likely provided enough evidence that the association should be considered a state actor.

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200. Presuming it is not illegal under federal or state law.

201. Note that this consideration, whether sufficient control to find state action is present, is similar to the Court’s analysis in determining whether a liberty interest sufficient to implicate the Due Process Clause should be found. See Bd. of Regents v. Roth, 408 U.S. 564, 573 (1972) ("There is no suggestion that the State, in declining to re-employ the respondent, imposed on him a stigma or other disability that foreclosed his freedom to take advantage of other employment opportunities.").
As noted above, the second control prong maintains the balance between the two main concerns that have historically supported the state action doctrine. Prior to the 1960s, the doctrine was largely a formal one, drawing bright lines based on the state's intentions and actions. However, as claimants began to suffer seemingly public injuries in private settings, the state action doctrine was broadened to take these circumstances into account.

While the first prong of the proposed framework is focused on the interests of the state, the second prong looks to the concerns of the claimant. The formalist rationale for the doctrine was grounded in the need to preserve the liberty interests of private entities in avoiding constitutional regulation. "Liberty" in this sense means a private actor's ability to freely move and develop within a social and economic sphere. The instrumentalist approach, on the other hand, was born out of a direct concern for the claimant, placing greater emphasis on the impact of private action that looked very much like unofficial state action. Racial discrimination was the primary catalyst for this shift. The second prong of the framework advocated here accounts for both of these concerns by placing the emphasis on the absence or presence of meaningful choice, the essence of liberty itself.

Of course, before the second prong can be applied, there must be some state involvement in the affairs of a quasi-private entity. Thus, these prongs are applied where they are most needed, in the difficult cases where the private entity is not a clear candidate for state actor status.

202. See Developments in the Law, supra note 26, at 1256–58 (discussing "classical legal thought" and its prominence in the Civil Rights Cases).

203. The White Primary Cases were a response to a series of attempts by the state of Texas to avoid constitutional constraints on its electoral process by increasingly delegating to private parties its discriminatory goals. The Court presumably evolved the doctrine to a more functional analysis—through the public function theory—out of a concern for stamping out racial discrimination in the electoral process. See CHEMERINSKY, supra note 20, at 535–37 (explaining that in these cases the Court concluded that elections, even when run by private political clubs, were essentially public functions).

204. See Developments in the Law, supra note 26, at 1258–59 (explaining that mid-twentieth century "social legal thought," recognized social interdependence and a more instrumentalist view of law).

205. I will not get into the larger philosophical implications of what may or may not constitute "liberty" in the individual or social context.

206. See Developments in the Law, supra note 26, at 1259 (discussing how the instrumentalist approach responded to the need to fill in gaps in positive law that permitted racism).

207. Id. at 1258 (noting that the seminal work on social legal thought acknowledged the eradication of racism as the greatest priority of the U.S. legal system).
To be sure, this framework is still fact dependent. It may not give tremendous guidance to future fact patterns without clear evidence of material interest or control. The nuances of each new case may intuitively push a court in one direction or the other, a phenomenon that has occurred time and again in previous state action cases. Indeed, singular frameworks like the one introduced here have been applied in other areas of constitutional law. Constitutional standing doctrine, for example, must be applied to a wide range of factual conditions but it is still guided by a consistent three-factor test: injury, causation, and redressability. Nevertheless, many scholars would argue that the seemingly consistent standing doctrine is anything but. There is no guarantee that the historical and ideological tensions that influence courts would not similarly warp the framework introduced here.

Nevertheless, even if judges feel compelled to emphasize certain facts to reach predetermined conclusions about state action, a universal framework forces them to better explain apparent deviations. At the very least, then, this framework will discipline courts to conduct a meaningful state action analysis—rather than simply picking a theory and running with it—and arrive at more transparent outcomes in the process. Moreover, like standing doctrine, scholars may be able to better critique state action decisions by focusing on a court’s reasons for deviating from the singular framework. At present, scholarly criticism of state action cases is limited because it is often not clear why courts emphasize certain factors over others.

Finally, the singular framework proposed here might be easier for the government to circumvent. With respect to material interest, legislators may become silent about the importance of a particular endeavor or even employ rhetoric to suggest its “clerical” nature. While this is a possibility, legislators and administrators would have to be willing to forgo the political benefits of touting materially important public initiatives—exactly what the material interest prong intends to capture—for the mere possibility of circumventing the state action doctrine in some future litigation. With respect to control, this inquiry looks to the options available to the private entity. If the state

208. See e.g., William A. Fletcher, The Structure of Standing, 98 YALE L.J. 221, 223 (1988) (discussing the “apparent lawlessness . . . [and] the wildly vacillating results” of standing cases).

209. See supra text accompanying notes 27–36 (describing instances in which courts have skimmed over a state action analysis).
wished to improve the availability of alternatives in order to minimize evidence of its control, then the inquiry should lead to the conclusion that no state action exists.

E. Applying the New Framework to FINRA

1. Material Interest

The proposed framework should constrain a court’s analysis and make it considerably easier to apply the doctrine to FINRA. An analysis of but-for material interest should investigate the net accumulation of the government’s interest in FINRA’s affairs. With a long history of increasing congressional involvement, the accumulation of government activity provides a fairly good indication of whether the state has a material interest with respect to FINRA.

Given the extensive history relayed above, it becomes fairly apparent that the state has a significant interest in regulating the securities industry. The government’s increased involvement in the securities market, for example, has outpaced the general escalation in economic regulation. Congress and the SEC have intentionally sought to adopt, affirm, and fine-tune the SRO model as a means to curb specific abuses in the securities market in the 1930s, 1970s, 1980s, 1990s, and 2000s. While the explanations of Congress or SEC Commissioners are not dispositive in determining whether the government has a material interest, the government has repeatedly emphasized the importance of robust regulation of the securities market and the belief that the SRO model should be the primary mechanism for doing it.

210. The OTC market’s role in the period leading up to the Great Depression. See Friedman, supra note 18, at 738–39 (describing the extension of government supervision over the self-regulating NYSE and NASD).

211. The abuses were discovered through the only major independent study of the securities market since the 1930s. See Philip A. Loomis, Jr., Commissioner, Sec. & Exch. Comm’n, Joint Securities Conference 1975, at 2–3 (Nov. 18, 1975), available at http://perma.cc/5WXF-YQUF (laying out the events that culminated in the crisis of 1968–1971 and the ensuing legislation).

212. The absence of universal membership and compliance. See supra text accompanying note 129.

213. Karmel, supra note 36, at 16 (“The NASD was completely reorganized in 1996 in the wake of a Department of Justice and SEC investigation into anti-competitive practices by OTC market makers.”).

214. The Sarbanes-Oxley Act of 2002 as the post-Enron response to widespread abuses. Id. at 5.

215. This would just offer an incentive to remain silent about intent.

216. See SEC Concept Release Concerning Self-Regulation, supra note 107 (explaining the reasons for which Congress has historically favored self-regulation of the securities industry).
The government also has a material monetary interest in using the SRO model. Not only are firms required to be members of FINRA, but they must also fund it. This scheme results in significant savings for the SEC. The Commission can thus choose to devote its resources elsewhere.

The extent of the SEC's material interest means that FINRA satisfies the but-for element of the first prong. Every historical indication suggests that in the absence of an SRO such as FINRA, the government would regulate the securities market directly. The SEC would devote its resources to the same investigatory and enforcement activities currently relegated to FINRA.

2. Control

Technically, the proposed framework would end with a finding of material interest. Nevertheless, it is worth applying the second prong as well to determine whether significant control, from the perspective of the member firm, is present. At the very least, a showing of control would simply bolster a court's finding of state action.

Again, the applicable regulatory structure significantly constrains FINRA members. FINRA exerts meaningful control over its private members, given the statutory requirement for membership, its role as investigator, and its enforcement powers to levy fines and bar firms from practice. While members do enjoy some form of procedural review with the SEC and federal courts for FINRA's enforcement actions against them, it can hardly be argued that this significantly limits FINRA's level of control. This is because aside from member input in the rulemaking process, FINRA's regulations—through which enforcement actions are taken—are ultimately approved by FINRA and the SEC (not, for example, by a majority vote of FINRA's members).

As such, given the presence of both material interest and control, a court should classify FINRA as a state actor under the

217. Id.
218. See, e.g., supra text accompanying notes 176–77 (discussing the large staff and budget available to the NASD and NYSE as SROs).
219. See SEC Concept Release Concerning Self-Regulation, supra note 107 (discussing the historical development of the extension of federal regulation over SROs in the investment industry).
220. Id.
221. See Karmel, supra note 36, at 17–18 (noting that greater "autonomy and independence" of NASD staff was required during the 1996 reorganization and explaining that, as part of a settlement, the SEC required NASD to have a majority of non-industry members on its board).
framework articulated in this Note. Then, when a claimant asserts that FINRA violated the Due Process Clause, for example, courts could move away from the threshold state action question to the substantive question of how the Constitution should be applied in this quasi-private context.  

VI. CONCLUSION

The primary role of the state action doctrine is to create a meaningful public/private distinction in order to balance the risk of overextending constitutional constraints into the private sphere with the potential for abuse when the line between state and private activity blurs. The doctrine has developed in such a way, however, that consistent application has become nearly impossible. Analyzing FINRA illustrates this point because the leading theories can be reasonably manipulated to produce any result. Moreover, prior precedents have not been useful to courts trying to analyze unique forms of private activity. The circuits have split over whether to subject FINRA to constitutional constraints.

Consequently, in response to what many commentators see as a haphazard application of the doctrine by the courts, most state action scholarship advocates overhauling or abandoning the doctrine altogether. This Note, however, has taken a different approach. The framework proposed here is distilled from the theoretical and practical concerns that have characterized the state action doctrine since its origination in the Civil Rights Cases. Its goal is to constrain the state action doctrine into a reasonably predictable analytical inquiry.

The success of any framework depends on its ability to be consistently applied across a wide range of factual circumstances, both old and new. Part V of this Note tested the solution advocated here against some of the leading state action cases and against the difficulties proposed by FINRA—a public/private entity unlike any other considered by the Supreme Court. While this new framework cannot entirely eliminate the need for analogous reasoning when the state creates increasingly novel ways to involve itself with the private sector, its application to FINRA shows that it can mitigate the most freewheeling aspects of the current doctrine. This proposed framework

222. In other words, instead of asking whether constitutional process is due, the court should be analyzing just how much process is due.
would go a long way toward clearing up the morass that the state action doctrine has become.

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