

SUPREME RISK

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Abstract

While many have discussed the social issues that might arise because of a majority-conservative Supreme Court, one critical consequence of the current Court has been overlooked: the role of the Court in generating or avoiding systemic risk. For some time, systemic financial risk has been regulated by a mix of self-regulatory organizations (SROs), such as the Depository Trust Corporation, and federal regulators such as the Financial Stability Oversight Council (FSOC). However, the Court's recent jurisprudence now creates real risk that federal courts will declare keystone SROs unconstitutional because they do not fit neatly into an eighteenth-century constitutional framework.

SROs are under-appreciated regulatory entities comprised of industry members regulating their own industries with deferential oversight from federal administrative agencies. While ordinary civics discussions entirely omit SROs, they play critical legal and economic roles and exercise expansive power delegated to them by the federal government. Yet, as nominally private entities, they enforce federal law and their own rules without abiding by the constitutional restrictions imposed on governmental entities, such as providing due process.

This Article makes three contributions to the literatures in financial regulation and constitutional law—disciplines that rarely interact. First, it provides a detailed account of how SROs became functionally integrated into the federal government and serve as federal law enforcement and regulators. Second, it shows how four different constitutional doctrines, now resurging under a majority-conservative Supreme Court, pose existential threats to existing SRO models. Third, this Article explains how Supreme Court decisions declaring SROs unconstitutional or limiting their powers generate systemic risk and may trigger a financial crisis as well as how possible measures can mitigate this risk.

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the U.S. electrical grid,² the brokerage industry,³ derivatives markets,⁴ securities exchanges,⁵ municipal securities,⁶ and other markets. These SROs have become so important and entwined with markets and traditional regulatory agencies that some have described them as an emerging fifth branch of government.⁷ SROs exist because of political compromises made in the 1930s, not because any participant at the 1787 Constitutional Convention ever persuaded anyone to authorize them.⁸ In contrast to traditional administrative agency design, which aims at ensuring that regulatory bodies remain independent from industry, the SRO model grants industries control over regulation under deferential federal oversight.⁹ The executive branch generally lacks control over SRO leadership, with industries electing their own members to serve on governing boards.¹⁰ Despite SRO centrality and importance, little thought has been devoted to the systemic risk that the national and global economy faces should the Supreme Court of the United States suddenly declare the SRO model unconstitutional or otherwise invalidate financial regulation.¹¹ Financial markets might collapse if SROs lost the power to

2. The North American Electric Reliability Corporation (NERC) was formed in 2006 and is overseen by the Federal Energy Regulatory Commission (FERC). NERC is an SRO statutorily described as an “Electric Reliability Organization” or “ERO.” 16 U.S.C. § 824o(a)(2) (stating that an ERO is an organization “certified by the Commission . . . the purpose of which is to establish and enforce reliability standards for the bulk-power system, subject to Commission review”).

3. See 15 U.S.C. § 78o-3(a) (explaining that “[a]n association of brokers and dealers may be registered as a national securities association”).

4. The National Futures Association describes itself as “the industrywide SRO for the U.S. derivatives industry.” NAT’L FUTURES ASS’N, ANNUAL REVIEW 28 (2020), https://www.nfa.futures.org/about/annual-reviews-files/2020_annualreview.PDF [<https://perma.cc/K4NL-ABLF>].

5. 15 U.S.C. § 78f(a) (authorizing national securities exchanges to register as SROs under the Securities and Exchange Commission’s oversight).

6. MUN. SEC. RULEMAKING BD., THE ROLE AND JURISDICTION OF THE MSRB 2 (2021), <https://www.msrb.org/msrb1/pdfs/Role-and-Jurisdiction-of-MSRB.pdf> [<https://perma.cc/284K-6JF8>] (explaining that the MSRB “was established by Congress in 1975 and charged with a mandate to protect municipal securities investors, municipal entities, obligated persons[,] and the public interest”).

7. William A. Birdthistle & M. Todd Henderson, *Becoming a Fifth Branch*, 99 CORNELL L. REV. 1, 24–25 (2013) (describing the “governmentalization” of financial SROs over time).

8. Saule T. Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 466 (2011) (explaining that SROs are “largely a product of political compromise and economic expediency” (footnote omitted)).

9. See Hammond, *supra* note 1, at 1748 (“Overall, the SRO schemes are structured—whether formally by statute or informally by practice—such that the oversight agencies give deference to their SROs and the many departures from administrative law norms are hidden.”).

10. See Benjamin P. Edwards, *The Dark Side of Self-Regulation*, 85 U. CIN. L. REV. 573, 614–15 (2017) (suggesting changes to the appointment process for SROs to increase public accountability).

11. Steven Schwarcz defines systemic risk as “the risk that (i) an economic shock such as market or institutional failure triggers (through a panic or otherwise) either (X) the failure of a

enforce their rules or if the Supreme Court simply declared them void. Recognizing that a Supreme Court decision limiting SROs or interfering with financial regulation poses systemic risk means that policymakers must plan for how to manage this risk now.

Even though SROs have operated with federal statutory authority since 1934, they remain vulnerable to constitutional challenges. Now, converging lines of judicial decisions create uncertainty about whether the Supreme Court will declare existing SRO structures unconstitutional.¹² Consider just one opinion. Prior to his appointment to the Supreme Court, Justice Brett Kavanaugh, then a judge on the U.S. Court of Appeals for the D.C. Circuit, authored an influential dissent in *Free Enterprise Fund v. Public Co. Accounting Oversight Board*,¹³ questioning the constitutionality of the Public Company Accounting Oversight Board (PCAOB).¹⁴ In his dissent, then-Judge Kavanaugh forcefully argued against giving “rise to a new ‘Fifth Branch’ of the Federal Government” on the theory that the PCAOB’s structure improperly interfered with the executive’s ability to control law enforcement, violating both separation of powers principles and the Appointments Clause.¹⁵ In 2010, the Supreme Court adopted much of then-Judge Kavanaugh’s view that limitations on the executive’s ability to remove members of the PCAOB violated the Constitution’s requirement for separation of powers.¹⁶ But the Court stopped before adopting his reasoning that the structure also violated the Appointments Clause.¹⁷

To be sure, others have recognized that SROs faced some constitutional risk after *Free Enterprise Fund v. Public Co. Accounting*

chain of markets or institutions or (Y) a chain of significant losses to financial institutions, (ii) resulting in increases in the cost of capital or decreases in its availability, often evidenced by substantial financial-market price volatility.” Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 204 (2008).

12. See Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?*, 14 STAN. J.L. BUS. & FIN. 151, 154 (2008) (“Regardless of whether the PCAOB should properly be categorized as a government regulator, a self-regulator, or neither, it is unlikely that the courts will decide that the NASD, which operated for almost seventy years as an SRO, has somehow become an unconstitutional government agency now that it has become FINRA.”).

13. 537 F.3d 667 (D.C. Cir. 2008), *aff’d in part, rev’d in part*, 561 U.S. 477 (2010).

14. *Id.* at 685–88 (Kavanaugh, J., dissenting).

15. *Id.* at 700.

16. *Free Enter. Fund*, 561 U.S. at 514 (“While we have sustained in certain cases limits on the President’s removal power, the Act before us imposes a new type of restriction—two levels of protection from removal for those who nonetheless exercise significant executive power. Congress cannot limit the President’s authority in this way.”)

17. *Id.* at 513–14 (finding that the “Constitution that makes the President accountable to the people for executing the laws also gives him the . . . authority to remove those who assist him in carrying out his duties”).

Oversight Board.¹⁸ Indeed, Professor Donna M. Nagy pointed out the risk to SROs before the Supreme Court decided *Free Enterprise Fund*.¹⁹ Since then, others have highlighted doubts about the constitutional status of other SROs, including the Municipal Securities Rulemaking Board (MSRB)²⁰ and Financial Industry Regulatory Authority (FINRA).²¹ Although the constitutionality of longstanding SROs was not before the Court in *Free Enterprise Fund*, Chief Justice John Roberts distinguished the PCAOB from the New York Stock Exchange (NYSE), another SRO, on the ground that the PCAOB “is a Government-created, Government-appointed entity, with expansive powers to govern an entire industry.”²² In contrast, the NYSE operated first as a private organization which was later granted power by the federal government.²³

The Supreme Court’s doctrinal trend now amplifies risk for SROs at a constitutional level. It may be particularly difficult to distinguish SROs from government agencies, considering reforms that allow at least one supervising federal agency to amend an SRO’s rules as it sees fit.²⁴ There is not much daylight between a government-created, government-appointed SRO and today’s government-authorized, government-controlled SROs. These weak distinctions may prove insufficient to

18. 561 U.S. 477 (2010).

19. Donna M. Nagy, *Is the PCAOB a “Heavily Controlled Component” of the SEC?: An Essential Question in the Constitutional Controversy*, 71 U. PITT. L. REV. 361, 364 (2010) (“[N]o matter what constitutional verdict is ultimately rendered for the PCAOB, the Court’s decision may affect the self-regulatory organizations (SROs) in the securities industry, such as New York Stock Exchange (NYSE) and the Financial Industry Regulatory Authority (FINRA) (formerly, the National Association of Securities Dealers (NASD)).”).

20. Richard E. Brodsky, “*Something Called the ‘Municipal Securities Rulemaking Board’*”: *Unexamined Issues of Constitutionality*, 8 AM. U. BUS. L. REV. 23, 65 (2019) (“A serious argument can be made that Congress acted unconstitutionally when it mandated the creation of the MSRB.”).

21. See Robert Botkin, *FINRA and the Developing Appointments Clause Doctrine*, 17 WAKE FOREST J. BUS. & INTELL. PROP. L. 627, 630 (2017) (“As more challenges under the Appointments Clause arise, Self Regulatory Organizations (SROs) could be caught within the crosshairs.”); Joseph McLaughlin, *Is FINRA Constitutional?*, 12 ENGAGE: J. FEDERALIST SOC’Y PRAC. GRPS. 111, 113 (2011), <https://fedsoc.org/commentary/publications/is-finra-constitutional> [<https://perma.cc/JX94-PTVM>] (arguing that if FINRA wields executive power within the meaning of the Constitution, then “*Free Enterprise Fund* inevitably leads to the conclusion that FINRA is unconstitutional because the President’s ability to control FINRA is even less than that deemed insufficient in *Free Enterprise Fund*”).

22. *Free Enter. Fund*, 561 U.S. at 484–85.

23. See Roberta S. Karmel, *Turning Seats into Shares: Causes and Implications of Demutualization of Stock and Futures Exchanges*, 53 HASTINGS L.J. 367, 400 (2002) (explaining that “stock exchanges were private membership organizations under state law” that registered with the SEC after the passage of federal securities regulations). Instead of having leadership appointed by a federal agency, industry-created SROs typically elect and appoint their own leadership. See Edwards, *supra* note 10, at 614.

24. See Section I.A.

sustain SROs if they are subjected to direct scrutiny before a majority-conservative Supreme Court, freshly revitalized with Trump-era appointees.

Recent changes to the Supreme Court's composition mean that the risk that courts will prune away the fifth branch may be greater than ever before as constraints on the administrative state increase.²⁵ SROs will surely draw close scrutiny because they possess governmental power without public accountability, creating "an unstable and unsustainable structure."²⁶ Some of the issues and doctrines highlighted in this Article have been pitched to the Supreme Court before. Consider the effort to secure certiorari in the wake of the U.S. Court of Appeals for the Second Circuit's decision in *Standard Investment Chartered, Inc. v. National Association of Securities Dealers*.²⁷ In a per curiam opinion, the Second Circuit ruled that SRO officials were "absolutely immune from private damages" from suits alleging that officials made false statements to induce industry firms to vote in favor of reconstituting the SRO.²⁸ The court treated the alleged false statements as having been made as part of the SRO's exercise of its regulatory functions, entitling it to absolute immunity.²⁹ Amicus briefing by the Cato Institute and the Competitive Enterprise Institute argued in 2011 that the SRO arrangement frustrated "political accountability" and executive control "due to the layers of authority separating FINRA from executive branch officers."³⁰ These types of arguments will likely find more receptive Justices with the current Supreme Court. The next time these issues arise for possible review, there may be enough votes to secure certiorari.

As quasi-governmental organizations, SROs introduce constitutional complexity and uncertainty, blurring lines between private and public.³¹ For decades, SROs have enforced federal law and their own rules over entire industries without affording enforcement targets the protection

25. See Hannah Mullen & Sejal Singh, *The Supreme Court Wants to Revive a Doctrine that Would Paralyze Biden's Administration*, SLATE (Dec. 1, 2020, 12:56 PM), <https://slate.com/news-and-politics/2020/12/supreme-court-gundy-doctrine-administrative-state.html> [<https://perma.cc/7JD7-NQRJ>].

26. Birdthistle & Henderson, *supra* note 7, at 6.

27. 637 F.3d 112, 114 (2d Cir. 2011) (per curiam).

28. *Id.*

29. *Id.* at 116.

30. Brief *Amici Curiae* of the Cato Institute and the Competitive Enterprise Institute in Support of Petitioner at 7, *Standard Inv. Chartered, Inc. v. Nat'l Ass'n of Sec. Dealers*, 565 U.S. 1173 (2012) (No. 11-381), 2011 WL 5128121.

31. See Jennifer M. Pacella, *If the Shoe of the SEC Doesn't Fit: Self-Regulatory Organizations and Absolute Immunity*, 58 WAYNE L. REV. 201, 208 (2012) (explaining that SROs "appear to be conveniently targeted as 'quasi-governmental' organizations when it comes to immunity protections . . . [and] private organizations for a number of other purposes, including . . . the denial of constitutional due process protections").

against self-incrimination or due process.³² At the same time, these SROs often enjoy the same sovereign immunity as government agencies do when they exercise regulatory authority.³³

SRO governance models also embed conflicts of interest into industry governance by blending public power with private ordering. Although not all SROs are themselves simultaneously profit-seeking corporations, many are. This structure forces SROs to continually balance their obligations as regulators and their obligations to their shareholders. For example, Nasdaq, Inc., a for-profit corporate SRO, prominently warns investors that the business model contains a significant risk factor because it owes “self-regulatory obligations and also operate[s] for-profit businesses.”³⁴ Nasdaq explains that “these two roles may create conflicts of interest,” and that it has “obligations to regulate and . . . ensure compliance with applicable law and the rules of [its] markets.”³⁵

Critically, the effects of a court decision declaring a significant SRO unconstitutional would likely extend well beyond any single market overseen by the particular SRO. For example, consider what might happen if the Supreme Court declared all rules enacted by the MSRB unconstitutional and void, with language indicating that it would likely declare actions by other, similarly structured SROs unconstitutional. The decision could impact municipal bond prices and potentially trigger significant insurance payouts and impacts in futures markets. The point is not to say that the shock would unfold in any single way, but that the effect of such a decision could extend beyond a single market regulated by the SRO before the Supreme Court. The underlying rationale for the

32. See, e.g., *United States v. Solomon*, 509 F.2d 863, 867–69 (2d Cir. 1975) (finding that an SRO compelling a member to answer questions in the SRO’s investigation does not violate the Fifth Amendment because the SRO is not a state actor); *Jones v. SEC*, 115 F.3d 1173, 1183 (4th Cir. 1997) (finding that “the NASD is a private party and not a governmental agent”). *But see* *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) (“Due process requires that an NASD rule give fair warning of prohibited conduct before a person may be disciplined for that conduct.”).

33. See *Standard Inv. Chartered, Inc.*, 637 F.3d at 115 (“There is no question that an SRO and its officers are entitled to absolute immunity from private damages suits in connection with the discharge of their regulatory responsibilities.”); *Mohlman v. FINRA, Inc.*, No. 3:19-cv-154, 2020 WL 905269, at *3 (S.D. Ohio Feb. 25, 2020) (“FINRA is immune ‘from suit for conduct falling within the scope of the SRO’s regulatory and general oversight functions.’” (quoting *D’Alessio v. N.Y. Stock Exch., Inc.*, 258 F.3d 93, 105 (2d Cir. 2001))), *aff’d*, 977 F.3d 556 (6th Cir. 2020); *Hurry v. FINRA, Inc.*, No. CV-14-02490, 2015 WL 11118114, at *5 (D. Ariz. Aug. 5, 2015) (concluding that, because regulatory immunity derives from sovereign immunity, it extends to FINRA employees carrying out their duties), *aff’d*, 782 F. App’x 600 (9th Cir. 2019).

34. Nasdaq, Inc., Annual Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934 for the Fiscal Year Ended December 31, 2020 (Form 10-K) 25 (Feb. 23, 2021), <https://ir.nasdaq.com/sec-filings/sec-filing/10-k/0001120193-21-000011> [<https://perma.cc/5U6H-A7QT>].

35. *Id.*

decision would immediately weaken the authority of other SROs, causing uncertainty to ripple through their markets as well.³⁶

Financially, the impact of such a decision could run into the billions, if not trillions, of dollars. Some SROs have even been designated as financial market utilities, meaning that an interruption in their operations could threaten the financial stability of the U.S. financial system.³⁷ Yet the fact that these SROs often play critical roles in supporting financial market infrastructure has no bearing on whether their structure and authority fits within the U.S. constitutional system.

Judicial decisions could trigger these consequences without judges or Justices intending or foreseeing these effects. Judges and Justices may mistakenly believe that markets will seamlessly adapt to their decisions, or simply fail to foresee consequences which may flow from declaring an SRO arrangement unconstitutional. As modern financial markets are complex and interconnected, a decision striking a critical piece of financial market infrastructure will likely reverberate through markets, causing consequences elsewhere in the real economy. For example, consider how a decision causing major banks to temporarily suspend bond issuance during a period of judicially created uncertainty could affect the real economy. If the bond markets ceased providing capital, issuers would no longer be able to use offering proceeds to fund their operations. This means paychecks would not go out, and invoices for ordinary things like power, water, and electricity would go unpaid. The real economy depends on stable and accessible financial markets to function.

This Article demonstrates the need to act to manage the systemic risk posed by the SRO model in the current constitutional era. Part I provides an overview of the SRO regulatory model, shedding light on a critically important yet notoriously understudied regulatory model.³⁸ It captures what many others have missed: the way gradual changes have transformed SROs to more closely resemble de facto arms of the federal

36. See Kathryn Judge, *Fragmentation Nodes: A Study in Financial Innovation, Complexity, and Systemic Risk*, 64 STAN. L. REV. 657, 697 (2012) (“When a signal conveys new information suggesting that an investor has dramatically underappreciated the nature or magnitude of a risk to which he is exposed, that revelation introduces the possibility that the investor may also be exposed to other underappreciated risks.”).

37. 12 U.S.C. § 5462(9).

38. Jonathan Macey & Caroline Novogrod, *Enforcing Self-Regulatory Organization’s Penalties and the Nature of Self-Regulation*, 40 HOFSTRA L. REV. 963, 963 (2012) (“Few issues are as poorly understood and under-theorized as the concept of ‘industry self-regulation.’”); Andrew F. Tuch, *The Self-Regulation of Investment Bankers*, 83 GEO. WASH. L. REV. 101, 105 (2014) (explaining that FINRA’s “self-regulation of investment bankers has thus far attracted scant scholarly attention”); Omarova, *supra* note 8, at 414–15 (“[W]hat is conspicuously absent from the . . . broader debate among academics and policy-makers, is a meaningful discussion of the role and shape of industry self-regulation in the emerging postcrisis regulatory order . . .”).

government. These SROs now often enforce, interpret, and apply federal law in a symbiotic relationship with their supervising agencies. Part I also addresses the critical roles SROs play in our financial system and explains how markets could collapse should a court decision suddenly declare an SRO unconstitutional.

In Part II, this Article details specific constitutional doctrines resurging under a majority-conservative Supreme Court. It analyses recent cases—moving beyond the decade-old implication from *Free Enterprise Fund*—to recognize the growing, additional risks.³⁹ Two major findings are worth mentioning. First, the post-Trump-era Supreme Court consistently favors ensuring that the President maintains control over the leadership of regulatory bodies.⁴⁰ Because many SROs cannot be directly overseen by presidential power and often elect and appoint their own leadership, SROs will inevitably draw additional scrutiny. The literature has not yet recognized the impact of the Supreme Court’s 2020 and 2021 decisions in *Seila Law LLC v. Consumer Financial Protection Bureau*⁴¹ and *Collins v. Yellen*,⁴² which both reinforce this conclusion and create additional risks for SROs.⁴³

Second, the Supreme Court appears poised to revitalize the nondelegation doctrine—a doctrine that had its heyday in the New Deal era, largely slumbering since. Although the precise contours of the doctrine, what it prohibits, and whether it even exists remains hotly disputed, expanding the nondelegation doctrine would likely place more limits on Congress’s ability to delegate power to SROs and administrative agencies.⁴⁴ Five Justices have expressed some form of interest in revisiting the doctrine.⁴⁵ Bringing the likely total to six, Justice Amy Coney Barrett previously supported an expanded role for nondelegation doctrine in habeas corpus cases as an academic.⁴⁶ In short, SROs face real danger from current constitutional law trends.

This Article does not argue that the Supreme Court *should* declare the SRO regulatory model unconstitutional or that the decisions and trends creating these risks were correctly decided. Yet blithely insisting that the Supreme Court would be wrong to declare SROs unconstitutional would do little good to prepare for the aftermath of this type of readily

39. See *infra* Part II.

40. See *id.*

41. 140 S. Ct. 2183 (2020).

42. 141 S. Ct. 1761 (2021).

43. *Seila Law LLC*, 140 S. Ct. at 2191–92; *Collins*, 141 S. Ct. at 1770.

44. Section II.A discusses nondelegation doctrine in more detail.

45. See *Gundy v. United States*, 139 S. Ct. 2116, 2131, 2148 (2019) (Gorsuch, J., dissenting); *id.* at 2130–31 (Alito, J., concurring); see also *Paul v. United States*, 140 S. Ct. 342, 342 (2019) (mem.) (Kavanaugh, J., respecting the denial of certiorari) (noting that Justice Gorsuch’s dissent in *Gundy* “warrant[s] further consideration in future cases”).

46. Amy Coney Barrett, *Suspension and Delegation*, 99 CORNELL L. REV. 251, 256 (2014).

foreseeable development. The goal of this Article is to highlight the systemic risk and the need to respond to it.

Lastly, Part III discusses the important practical and theoretical implications of recognizing the Supreme Court as a source of systemic risk. It provides guidance to SRO leadership, market participants, and policymakers on ways to manage risks to the global financial system which may emerge from a decision invalidating the SRO regulatory model. Prudent changes to existing SRO governance structures may reduce the likelihood that the Supreme Court will declare them unconstitutional. Of course, Congress need not preemptively abandon the SRO model entirely. Congress could engage in constitutional contingency planning and authorize executive action to assume SRO responsibilities should the Supreme Court declare the SRO model unconstitutional.

I. THE CRITICAL SRO REGULATORY MODEL

SROs play a critical role in the global economy and regulatory framework and serve as frontline regulators overseen by administrative agencies.⁴⁷ Although SROs have been used in a variety of regulatory contexts, they are most common in financial regulation. This Article touches on other SROs but predominantly focuses on SROs in financial regulation because SROs have been most heavily deployed to regulate financial service markets. Below, Section A describes the general structure for SROs. Section B details the expansive legal powers SROs now possess. Section C discusses common, lightly supervised governance structures for SROs. Section D briefly overviews common, nonconstitutional, theoretical justifications for embracing the SRO model as well.

A. *The SRO Model and History*

There are many different forms of industry self-regulation. Both federal and state governments delegate power to industry members and groups to control their own licensing or regulation.⁴⁸ In many states, industry members enjoy the authority to restrict entry into their professions by imposing and administering licensing examinations or

47. Gina-Gail S. Fletcher, *Benchmark Regulation*, 102 IOWA L. REV. 1929, 1970 (2017) (“The SRO is the first-tier regulator—it monitors and polices members, maintains industry integrity, and ensures compliance with adopted regulations. At the second tier is the relevant government agency that oversees the SRO.”).

48. See Nick Robinson, *The Multiple Justifications of Occupational Licensing*, 93 WASH. L. REV. 1903, 1918 (2018) (finding “state governments generally still decide what activities to license and then frequently delegate the actual implementation of licensing requirements to volunteer, or quasi-volunteer, boards of practitioners operating at the state level”).

erecting other barriers to entry.⁴⁹ In theory, these gatekeeping bodies protect the public from abuse in situations where the public cannot reliably evaluate service quality.⁵⁰

SROs protect the public by policing their own industries. Historically, SROs began with self-regulating stock exchanges.⁵¹ The law treated these organizations as private clubs that could set their own rules for how club members behaved.⁵² Functionally, private clubs could not entirely regulate and control the market because not every market participant opted to join these private clubs.⁵³ In the securities industry, many transactions occur outside of these self-regulating exchanges.⁵⁴ To corral industry members together into a self-regulating group, an industry association needs legal status and a requirement that market participants join the SRO.⁵⁵ The government's blessing of these arrangements empowers SROs to control their industries by controlling club membership.⁵⁶

Simply identifying the boundary between SROs and the government remains difficult. Consider the PCAOB—some view the entity as falling outside the SRO category because it was created by the government and because its leadership was appointed by the government.⁵⁷ In contrast, others classify it as an SRO because it enjoys power to enforce membership rules and impose professional standards.⁵⁸ Similarly,

49. *Id.* at 1921.

50. See Benjamin P. Edwards, *The Professional Prospectus: A Call for Effective Professional Disclosure*, 74 WASH. & LEE L. REV. 1457, 1489 (2017) (“Self-regulating professions often defend occupational licensing by arguing that it protects the public from abuse and exploitation when market forces fail.”).

51. See Karmel, *supra* note 23, at 400 (explaining that “stock exchanges were private membership organizations under state law”).

52. See James Fallows Tierney, *The Political Economy of Securities Industry Bars 3* (Feb. 24, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3761903 [<https://perma.cc/9JTG-MYDT>].

53. *Id.* at 17.

54. *Id.* at 21 n.91.

55. See SEC, RELEASE NO. 34–50700, CONCEPT RELEASE CONCERNING SELF-REGULATION, 69 Fed. Reg. 71,256, 71,257 (Dec. 8, 2004), <https://www.sec.gov/rules/concept/34-50700.htm> [<https://perma.cc/GU2E-73PZ>] (“[T]he Commission and leaders of the investment banking community generally agreed that an industry association needed official legal status in order to effectively carry out the task of self-regulating the OTC market.”).

56. See Tierney, *supra* note 52, at 3.

57. Stephen Bainbridge (@PrawfBainbridge), TWITTER (July 6, 2021, 7:52 PM), <https://twitter.com/PrawfBainbridge/status/1412560116025479169?s=20> [<https://perma.cc/TWV7-6Y45>] (“Unlike the self-regulatory organizations, however, the Board is a Government-created, Government-appointed entity” (quoting *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 485 (2010))).

58. See John C. Coffee, *Backstabbing in Washington: The Curious Case of the PCAOB*, CLS BLUE SKY BLOG (Sept. 21, 2015),

opinions diverge over whether FINRA, generally viewed as an SRO, should even be called an SRO today.⁵⁹

Putting differences of opinion over the definition of an SRO aside, this Article focuses on industry control over its own regulation through audited SROs under federal administrative agency oversight.⁶⁰ Describing these SROs as “audited” does not refer to professional accountants scrutinizing their financial reports. Instead, an overseeing federal agency relies on information provided by the SRO while verifying that the SRO uses sensible procedures to generate information with occasional spot-checks to confirm that the SRO provides accurate information.⁶¹

Although Congress embraced and empowered the SRO model in the aftermath of the Great Depression, Congress did not create it. Financial firms, particularly securities exchanges, have a long history of private market regulation.⁶² The New York Stock Exchange (NYSE), organized in 1792, has been privately regulating securities trading among its members since its inception.⁶³ Industry self-regulation initially served to fix prices with the initial NYSE members “solemnly promis[ing] . . . not [to] buy or sell . . . for any person whatsoever, any kind of public stock, at a less rate than one quarter per cent commission on the specie value and [to] give a preference to each other in [their] negotiations.”⁶⁴ Although the early NYSE claimed to also protect the public, most of its

<https://clsbluesky.law.columbia.edu/2015/09/21/backstabbing-in-washington-the-curious-case-of-the-pcaob/> [<https://perma.cc/SZ6Y-PT48>] (describing the PCAOB as an SRO because its “authority (unlike that of the SEC) goes well beyond anti-fraud rules and permits [it] to enforce the ‘rules of the club’—i.e., professional standards”).

59. Hester Peirce, *The Financial Industry Regulatory Authority: Not Self-Regulation After All* 3 (Mercatus Ctr., Working Paper, 2015), <https://www.mercatus.org/system/files/Peirce-FINRA.pdf> [<https://perma.cc/V8GX-YWBV>] (“FINRA is not the self-regulatory organization (SRO) some imagine it to be. . . . [I]ts governance structure means that it is not accountable to the industry it regulates the way an SRO would be.”).

60. See Douglas C. Michael, *Federal Agency Use of Audited Self-Regulation as a Regulatory Technique*, 47 ADMIN. L. REV. 171, 175–77 (1995) (“‘Audited self-regulation’ is defined as the delegation by Congress or a federal agency to a nongovernmental entity the power to implement laws or agency regulations, with powers of review and independent action retained by a federal agency.”).

61. *Id.* at 176.

62. See Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1457 (1997) (“For most of their history, then, exchanges have been the primary regulators of securities markets.”).

63. See Karmel, *supra* note 12, at 159 (“The NYSE was organized in 1792 to govern securities trading in the wake of a scandal in the government bond market in the early days of the United States.”).

64. *The Institution of Experience: Self-Regulatory Organizations in the Securities Industry, 1792-2010*, SEC HIST. SOC’Y, <http://www.sechistorical.org/museum/galleries/sro/sro02b.php> [<https://perma.cc/4K23-JUY9>].

early enforcement activity aimed to discipline members for violating its minimum commission rules.⁶⁵

Congress began to regulate securities markets and endow the SRO regulatory model with federal authority in the 1930s. As a first step, Congress passed the Securities Act of 1933,⁶⁶ embracing a disclosure regime for securities offerings that paralleled the NYSE's approach.⁶⁷ One year later, Congress passed the Securities and Exchange Act of 1934⁶⁸ (Exchange Act), creating the Securities and Exchange Commission (SEC) and delegating federal authority to national securities exchanges registering with the SEC.⁶⁹ The Exchange Act effectively transformed the NYSE and regional stock exchanges from purely private clubs into the first audited SROs.⁷⁰

The SRO model put federal authority behind the exchanges while allowing them to maintain their leadership role and independence.⁷¹ Former SEC Chair and later Supreme Court Justice William O. Douglas famously characterized the SEC's oversight role as "letting the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used."⁷²

Congress expanded its reliance on SROs in 1938 by passing the Maloney Act⁷³ to regulate off-exchange securities trading.⁷⁴ The legislation authorized the creation of one or more SROs to regulate over-the-counter markets, such as trading done outside of exchanges already

65. See Edwards, *supra* note 10, at 579–80.

66. Ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa).

67. See Kristin N. Johnson, *Governing Financial Markets: Regulating Conflicts*, 88 WASH. L. REV. 185, 202–03 (2013) ("When federal legislators adopted statutes regulating securities market transactions nearly one hundred years later, Congress instituted a mandatory disclosure-oriented regime that paralleled the NYSE's approach.").

68. Ch. 404, 48 Stat. 811 (codified as amended at 15 U.S.C. §§ 78a–78qq).

69. 15 U.S.C. § 78d(a) ("There is hereby established a Securities and Exchange Commission . . ."); *id.* § 78f(a) ("An exchange may be registered as a national securities exchange under the terms and conditions hereinafter provided in this section . . .").

70. See William I. Friedman, *The Fourteenth Amendment's Public/Private Distinction Among Securities Regulators in the U.S. Marketplace-Revisited*, 23 ANN. REV. BANKING L. 727, 728–30 (2004) (discussing the transformation of the NYSE into an SRO).

71. *Id.* at 728.

72. WILLIAM O. DOUGLAS, *DEMOCRACY AND FINANCE: THE ADDRESSES AND PUBLIC STATEMENTS OF WILLIAM O. DOUGLAS AS MEMBER AND CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION* 82 (James Allen ed., 1940).

73. Ch. 677, 52 Stat. 1070 (1938) (codified as amended at 15 U.S.C. § 78o-3).

74. See Comment, *Over-the-Counter Trading and the Maloney Act*, 48 YALE L.J. 633, 637–44 (1939) ("The Maloney Act is intended to deal with those factors which prevent the over-the-counter markets, in their present unorganized condition, from giving the investing public the same uniformly fair treatment which the Commission has by regulation made available upon the national securities exchanges.").

regulated and subject to SEC oversight, through the SRO model.⁷⁵ Shortly after Congress passed the Maloney Act, the SEC approved the National Association of Securities Dealers' (NASD) application to serve as the SRO for brokerage firms.⁷⁶ In 2007, the NASD merged with a regulatory arm of the NYSE to form FINRA.⁷⁷

For a time, the SEC attempted to offer an alternative to SRO regulation for brokerage firms operating in the over-the-counter marketplace. The SEC Only registration program (SECO) ran for eighteen years.⁷⁸ Upon SECO's closure in 1983, Congress amended the Exchange Act to require brokerages to register with an SRO to remain in business.⁷⁹ A House Congressional Report on the legislation deemed SRO enforcement superior because it allowed for a broader range of enforcement tools.⁸⁰ The Report recognized that the industry SRO could do things the SEC could not, including promulgating "ethical standards" as well as promoting "just and equitable principles of trade."⁸¹ It also recognized that attempting to make the SECO registration program equivalent to the industry SRO would require significant, additional expenditures by the SEC.⁸²

Now, many industries find themselves governed by a tag team of regulators—a federal agency and an ostensibly private SRO overseen by the federal agency. For example, Congress created the Commodity Futures Trading Commission (CFTC) in 1974,⁸³ which simultaneously embraced the SRO regulatory model for futures markets.⁸⁴ Authorized by the same legislation as the CFTC, the National Futures Association (NFA) now oversees the futures markets under the CFTC's supervision.⁸⁵ In authorizing the NFA, Congress desired a "private sector self-regulatory organization [to] serve the futures industry more efficiently

75. § 15A(a), 52 Stat. at 1070 (codified as amended at 15 U.S.C. § 78o-3).

76. See NAT'L ASS'N OF SEC. DEALERS, INC., at i (1997), <https://www.finra.org/sites/default/files/Corporate/p009762.pdf> [<https://perma.cc/S5G2-EKL2>].

77. See Nancy Condon & Herb Perone, *NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority – FINRA*, FINRA (July 30, 2007), <https://www.finra.org/media-center/news-releases/2007/nasd-and-nyse-member-regulation-combine-form-financial-industry> [<https://perma.cc/7LLE-PC4H>].

78. See SEC, *supra* note 55, at 71,267.

79. *Id.*

80. See H.R. REP. NO. 98-106, at 6 (1983), as reprinted in 1983 U.S.C.C.A.N. 592, 597.

81. *Id.*

82. *Id.* at 6–7.

83. Pub. L. No. 93-463, § 101(a)(3), 88 Stat. 1389, 1389 (codified as amended in scattered sections of 5 U.S.C. and 7 U.S.C.).

84. *Id.* § 301.

85. *About NFA*, NAT'L FUTURES ASS'N, <https://www.nfa.futures.org/about/index.html> [<https://perma.cc/XW4K-E8TY>].

and at a lesser cost than would the government.”⁸⁶ Despite being a “private” organization, membership in the SRO remains mandatory for industry members.⁸⁷

SROs use their private status to enforce vague rules in ways that an ordinary administrative agency could not. Consider the Federal Communications Commission’s (FCC) indecency policy held unconstitutional by the Supreme Court in *FCC v. Fox Television Stations, Inc. (Fox)*.⁸⁸ The FCC penalized broadcasters for airing content it deemed “indecent,” such as George Carlin’s famous “Filthy Words” monologue.⁸⁹ There, the Supreme Court explained that vague indecency prohibitions violated basic due process requirements.⁹⁰ These rules apply when a state actor makes rules penalizing conduct.

In contrast, an SRO, ostensibly a private organization, may not be bound by constitutional requirements, allowing it to enforce vague and undefined rules. A private organization can regulate and oversee its members in ways that a public agency cannot because a private organization is not a state actor. Consider FINRA Rule 2010, which provides that a FINRA “member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.”⁹¹ This lacks any clear meaning. Professors William A. Birdthistle and M. Todd Henderson theorized “that the rule operates to capture conduct that cannot be efficiently or easily proved to violate another rule, but that FINRA believes is worthy of sanction.”⁹² They explain that “the vagueness of Rule 2010 is its power, in that it lowers monitoring and enforcement costs and provides a broad net to catch bad brokers who would escape punishment in a more formalistic environment.”⁹³

Consider how society might differ if the SRO model had been used to control more industries. If an SRO had issued and enforced the decency regulations at issue in *Fox* instead of the FCC, American television broadcasts might be remarkably different today. A private club may

86. *NFA History*, NAT’L FUTURES ASS’N, <https://www.nfa.futures.org/about/nfa-history.html> [https://perma.cc/LU38-3D6E].

87. *Id.*

88. 567 U.S. 239, 258 (2012).

89. See *FCC v. Pacifica Found.*, 438 U.S. 726, 750–55 (1978) (appending George Carlin’s monologue).

90. *Fox*, 567 U.S. at 253.

91. FINRA, RULE 2010 (2021), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2010> [https://perma.cc/J9T8-CVSD].

92. Birdthistle & Henderson, *supra* note 7, at 62.

93. *Id.* at 63. Although there is some constraint on this because a FINRA sanction may be appealed to the SEC, and then onward to federal courts.

enforce its own vague rules however it deems appropriate. George Carlin's famous monologue might never have been broadcasted.⁹⁴

As the SRO model grew, SROs became more entwined with federal agencies in ways that raise questions about their status as private rather than state actors. In 1975, Congress amended the Exchange Act yet again to give the SEC more power over the SROs that it oversees.⁹⁵ Now, the SEC has the power to approve SRO rule changes and the ability to require an SEC-supervised SRO to enact or modify any rule as the SEC deems necessary.⁹⁶ This means that the SEC can simply edit an SRO's rules at any time.⁹⁷ These changes effectively entwined the SEC and its SROs, making it difficult to characterize the SEC's role as purely oversight.⁹⁸

The SEC's power to enact or modify SRO rules also creates new and unexplored constitutional questions. The SEC might desire a rule beyond its ordinary enactment authority. Could the SEC modify the SRO's rules to require the SRO to do something that the SEC itself could not do? For example, the SEC might require FINRA to impose additional, prior restraints on advertisements about certain financial products or strategies. After all, FINRA already requires brokerages to preclear certain advertisements.⁹⁹ The SEC might also informally encourage the SRO to enact such a rule on its own to avoid the need to initiate a rulemaking process. This power to simply approve an SRO regulation may effectively enable the SEC to use the SRO as a puppet to regulate the markets in ways that circumvent the SEC's constitutional limitations.

SROs may be able to take action after an informal request without the SEC ever needing to take any public, affirmative step to approve the conduct. Some SRO rule changes do not require SEC approval before taking effect. For example, rule proposals clarifying the meaning of existing SRO rules may be given immediate effect.¹⁰⁰ Similarly, changes to fees or rules concerning an SRO's internal affairs may be immediately

94. Of course, having to play within constitutional rules would increase enforcement costs for SROs.

95. Pub. L. No. 94-29, 89 Stat. 97 (1975).

96. See Karmel, *supra* note 12, at 159–60.

97. See 15 U.S.C. § 78s(c) (stating that the SEC may by rule “add to, and delete from . . . the rules of a self-regulatory organization . . . to insure the fair administration of the self-regulatory organization, to conform its rules to requirements of this chapter . . . or otherwise in furtherance of the purposes of this chapter”).

98. Richard L. Stone & Michael A. Perino, *Not Just a Private Club: Self Regulatory Organizations as State Actors when Enforcing Federal Law*, 1995 COLUM. BUS. L. REV. 453, 463 (explaining that the SEC's “involvement with the SROs' rule-making process is much more extensive than it was prior to 1975, and is clearly greater than merely one of oversight”).

99. See, e.g., FINRA, RULE 2220 (2021) (regulating communications about options).

100. 15 U.S.C. § 78s(b)(3).

effective without SEC approval.¹⁰¹ This leaves substantial room for significant and immediately effective SRO rules.

The statutory provision giving the SEC authority to amend SRO rules seems to enable the SEC to shift accountability for its binding rules to SROs. The statutory provision specifically declares that amendments to SRO rules by the SEC “shall be considered for all purposes of this chapter to be part of the rules of such self-regulatory organization and shall not be considered to be a rule of the Commission.”¹⁰²

This is not to say that federal administrative agencies exercise total control over the SROs they oversee. Functionally, industry members usually retain substantial influence over the SRO. This creates an incentive for the SRO to seek some middle ground to avoid upsetting its members with overly intrusive action while also remaining active enough to keep the SEC’s “shotgun” behind the door.¹⁰³

B. *Expansive SRO Powers to Enforce Federal Law*

Many SROs exercise significant power under federal law and entirely control access to their industries. In practice, this means that they wield federal power to drive regulatory policy and control how federal law is enforced within their zone of influence.

1. Enforcing Federal Law Without Presidential Control

Ordinary depictions of the federal government present the executive and administrative state as responsible for enforcing federal law pursuant to the Take Care Clause in Article II of the U.S. Constitution.¹⁰⁴ Yet statutes authorizing SROs often mandate that an SRO must enforce federal law when overseeing its members without regard for presidential control.¹⁰⁵ The statute authorizing exchanges to register as SROs requires that to maintain its registration, an SRO’s members and persons associated with its members “shall be appropriately disciplined for violati[ng]” the Exchange Act as well as federal rules and regulations by a broad range of penalties.¹⁰⁶ Similarly, federal law requires FINRA to enforce the Exchange Act, the Exchange Act Rules, FINRA’s own rules,

101. *Id.*

102. *Id.* § 78s(c)(4)(C).

103. *See* Edwards, *supra* note 10, at 599–600 (explaining that industry members of an SRO have a limited incentive to self-police).

104. U.S. CONST. art. II, § 3.

105. *See* Stone & Perino, *supra* note 98, at 463 (“[T]he compulsion for SROs to perform enforcement activities and the delegation of law enforcement functions to the SROs . . . suggests that SROs should be viewed as state actors when enforcing federal law.”).

106. 15 U.S.C. § 78f(b)(6) (emphasis added).

and MSRB rules.¹⁰⁷ These requirements effectively force SROs to serve as frontline enforcers of federal law and policy.

Functionally, federal law could not be enforced with current resources absent SROs. For instance, the SEC could not effectively oversee markets without SROs today. At its current staffing and funding level, the SEC only has a total of 4,441 employees spread across five divisions and twenty-five different offices.¹⁰⁸ Yet its oversight encompasses over 7,600 reporting companies, more than 28,000 registered entities, seven different clearing agencies, twenty-four national securities exchanges, and nine credit rating agencies.¹⁰⁹

Although statutorily mandated to enforce federal law, SROs control their own staffing, resource allocations, and investigative priorities and may not always opt to vigorously investigate and enforce federal law.¹¹⁰ SROs enjoy functional discretion over how they allocate their personnel and resources. This means that an SRO's priorities may not fully align with the executive branch's desires.

At times, SROs have failed to prevent truly massive harm and have missed significant violations of federal law. Consider the combined failure of the SEC and SROs to detect Bernard Madoff's record-shattering Ponzi scheme.¹¹¹ An after-action review of the failure generally described SRO reviews of Madoff's operations and oversight examinations as lacking.¹¹² The SEC Office of Investigations noted that issues were "completely missed" with SRO staff examiners being described as conducting simple "checklist-type reviews" where they did not "think outside the box."¹¹³ To be fair to the SROs, the SEC also failed to uncover Madoff's massive fraud, and the after-action reports revealed significant problems with the SEC's oversight as well.¹¹⁴

SROs differ from federal agencies in that the President can more readily control federal agencies and make changes if dissatisfied with

107. *Id.* § 78s(g); see Alan Lawhead, *Useful Limits to the Fifth Amendment: Examining the Benefits That Flow from a Private Regulator's Ability to Demand Answers to Its Questions During an Investigation*, 2009 COLUM. BUS. L. REV. 210, 222 ("FINRA must enforce compliance by its members with the Exchange Act, including Exchange Act rules, and FINRA's rules.").

108. SEC, AGENCY FINANCIAL REPORT 7 (Nov. 12, 2020), https://www.sec.gov/files/sec-2020-agency-financial-report_1.pdf [<https://perma.cc/BL6Q-W68U>].

109. *Id.* at 125.

110. See Edwards, *supra* note 10, at 608 ("While traditional regulatory agencies may also be prone to inaction, self-regulatory bodies may be particularly lethargic protectors in situations where actions in the public's interest would undercut private profits.").

111. See generally SEC, OFF. OF INVESTIGATIONS, REPORT NO. OIG-509, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME (2009), <https://www.sec.gov/files/oig-509.pdf> [<https://perma.cc/RA52-PNXC>] (discussing various failures by the SRO Group when conducting examinations of Bernie Madoff's Ponzi scheme).

112. *Id.* at 176.

113. *Id.*

114. *Id.*

their performance. This can happen in different ways. By exercising the appointment power, the President can install leadership committed to prioritizing the President's agenda.¹¹⁵ Although sometimes limited by for-cause removal protections, the President also generally enjoys the power to remove the heads of executive agencies if the President is dissatisfied with their performance.¹¹⁶ Yet a president concerned about lax law enforcement practices of SROs has no direct power to make changes to SRO personnel. Indeed, the Supreme Court found the for-cause removal protections afforded to the PCAOB's leadership were unconstitutional because it perceived the limitation as unduly insulating it from presidential control.¹¹⁷

2. Controlling Access to Their Industries

Most enabling statutes for SROs mandate that industry participants join an SRO to conduct business.¹¹⁸ The requirement for industry members to maintain SRO membership gives the SRO leverage to compel its members to comply with its rules because the SRO can effectively put its industry members out of business by simply kicking them out of the SRO.¹¹⁹ Of course, this power will not always control behavior in situations where an industry member could, hypothetically, join a different SRO to make as much money in a similar industry not overseen by the former SRO.¹²⁰ Still, an SRO's ability to deny registration to a firm or impose a lifetime ban on an individual gives it substantial enforcement power.

In some instances, SROs may move more quickly and effectively to excise fraudsters, scoundrels, and miscreants from industries. Consider the NFA's decision to permanently ban Jacob Wohl from the futures industry. Wohl rose to infamy during former-President Donald Trump's campaign and administration for peddling a series of bogus claims about Senator Elizabeth Warren, former FBI director Robert Mueller, Chief

115. See, e.g., Lisa Friedman, *Senate Confirms Biden's Pick to Lead E.P.A.*, N.Y. TIMES (Mar. 15, 2021), <https://www.nytimes.com/2021/03/10/climate/michael-s-regan-epa-biden.html> [<https://perma.cc/29TM-3N9X>] (explaining that President Biden's top EPA appointment is likely to "drive some of the Biden administration's biggest climate and regulatory policies").

116. *Myers v. United States*, 272 U.S. 52, 134–35 (1926).

117. *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 484 (2010).

118. See 15 U.S.C. § 78o(b)(8) (requiring brokerage firms to join a registered securities association to be able to buy and sell securities).

119. Macey & Novogrod, *supra* note 38, at 966 ("SROs traditionally have been able to enforce their own rules without having to use the government's civil and criminal enforcement power . . . by maintaining a monopoly and using their credible threat to be able to exclude a participating firm from the cartel as its ultimate enforcement mechanism.").

120. *Id.*

Medical Advisor Anthony Fauci, President Joseph Biden, and others.¹²¹ In 2016, the NFA filed a complaint against then eighteen-year-old Wohl alleging that he had promoted himself and his firm in ways that were “unbalanced in their presentation of profit potential and risk of loss.”¹²² The NFA reached a decision in 2017 explaining a range of concerns, including that Wohl had allegedly taken a \$75,000 investment and claimed to have increased its value while refusing to return the investor’s funds, as well as the concern that Wohl refused to cooperate with the NFA’s investigation.¹²³ This NFA decision “permanently barred” Wohl “from NFA membership, associate membership, and from acting as a principal of an NFA member.”¹²⁴ It took the NFA approximately six months to permanently bar Wohl from the industry.¹²⁵

3. Limited Power Over Nonmembers

In most instances, an SRO’s ability to enforce its rules and federal law turns on whether the entity or person remains subject to the SRO’s jurisdiction. This is usually not a problem for those currently in the industry who typically must be members of the SRO or work for a member firm. Jurisdiction matters because it dictates when an SRO can force a person to comply with a sanctions order or force a person to provide testimony under the SRO’s version of a subpoena. FINRA, for example, typically loses jurisdiction over people two years after they leave the industry.¹²⁶ Persons escaping an SRO’s jurisdiction no longer have any incentive to cooperate with the SRO—raising enforcement and monitoring costs and potentially undercutting investor protection.

One notable case, *Fiero v. Financial Industry Regulatory Authority*,¹²⁷ showcases this dynamic.¹²⁸ In 2000, a FINRA panel expelled Fiero Brothers, Inc. from the FINRA and ordered Fiero Brothers to pay more than \$1 million in fines for violating federal securities laws and the SRO’s

121. Bridget Read, *All of Jacob Wohl’s Spectacularly Failed Smear Attempts*, CUT (May 7, 2020), <https://www.thecut.com/2020/05/who-is-jacob-wohl-failed-smears.html> [<https://perma.cc/8ZJJ-972F>] (explaining that “Jacob Wohl is simply unparalleled in the field of failed smear attempts”).

122. Complaint at 2, NEX Cap. Mgmt. LLC, NFA Case No. 16-BCC-011 (Aug. 19, 2016), <https://www.nfa.futures.org/basicnet/regulatory-actions-detail-doc.aspx?docid=4345&rnd=5543859a-fcea-4981-b0f5-3b276f32068b> [<https://perma.cc/ZX54-9ZWT>].

123. NEX Cap. Mgmt LLC, NFA Case No. 16-BCC-011, at 12 (Mar. 2, 2017), <https://www.nfa.futures.org/basicnet/regulatory-actions-detail-doc.aspx?docid=4428&rnd=5dfd6c10-0c6c-46e5-8b31-bcf0a201428f> [<https://perma.cc/J32W-RSG2>].

124. *Id.*

125. The initial complaint was filed in August of 2016, but Wohl was “permanently barred from NFA membership” in March of 2017. *See id.* at 1, 12.

126. FINRA, RETENTION OF JURISDICTION, <https://www.finra.org/rules-guidance/rulebooks/corporate-organization/retention-jurisdiction-0> [<https://perma.cc/2FKE-KAKA>].

127. 660 F.3d 569 (2d Cir. 2011).

128. *Id.* at 571.

rules.¹²⁹ Fiero Brothers did not pay the fine.¹³⁰ Three years later, FINRA initiated a state court action to collect the fine, proceeding on a breach of contract theory.¹³¹ On appeal, the New York Court of Appeals found that state courts lacked jurisdiction over the dispute because FINRA sought to collect for liability created under the Exchange Act.¹³² The Exchange Act specifies that federal courts have “exclusive jurisdiction” for “all suits in equity and actions at law brought to enforce any liability or duty created” by the Exchange Act.¹³³

After Fiero Brothers sought a declaratory judgment that it did not have to pay the fine, the issue eventually ended up before the Second Circuit which found that FINRA lacked statutory authority to enforce its fines through breach of contract actions.¹³⁴ The Second Circuit noted that “there is no express statutory authority for [SROs] to bring judicial actions to enforce the collection of fines.”¹³⁵ It concluded that FINRA lacked the power to bring court actions to enforce its fines because nothing in the Exchange Act granted FINRA that power.¹³⁶

FINRA argued that it should be able to enforce its fines by court action because FINRA promulgated a rule saying that it could go to court to collect.¹³⁷ The Second Circuit also rejected this argument by finding that the way FINRA enacted the rule, providing itself with the ability to collect fines, violated the Exchange Act.¹³⁸ It found that the rule was not properly promulgated because it did not go through the notice and comment process.¹³⁹

The *Fiero* decision illustrates how courts will confine an SRO’s authority over its members. Although the defect in the FINRA rule could be remedied by promulgating and enforcing a rule through the notice and comment process, the adoption of such a rule would still not give the SRO any authority over a person who was never a member of the SRO and thus, never contractually bound to follow its rules and submit to its discipline.

129. *Id.* at 572.

130. *Id.*

131. *Id.*

132. *FINRA, Inc. v. Fiero*, 882 N.E.2d 879, 881–82 (N.Y. 2008).

133. 15 U.S.C. § 78aa.

134. *Fiero*, 660 F.3d at 579.

135. *Id.* at 574.

136. *Id.* at 577.

137. *Id.* at 578.

138. *Id.*

139. *Id.* at 579 (stating that “the NASD improperly designated the 1990 Rule Change, it was never properly promulgated and cannot authorize FINRA to judicially enforce the collection of its disciplinary fines”).

C. *Varied and Lightly Supervised SRO Governance Structures*

Governance structures for SROs matter because they influence and control how SROs behave. An SRO with leadership unaccountable to the public may not react to matters of public concern or feel any significant pressure to act in the public's interest.

SROs employ a range of governance structures with varying degrees of public input in the composition of an SRO's senior leadership. While the public sometimes has a degree of direct influence over the senior leadership of an SRO, such as the PCAOB,¹⁴⁰ most SROs operate without any publicly appointed leadership.

The responsibility for policing SRO governance and performance belongs to the supervising federal agency—if it even has that power. Notably, the Federal Energy Regulatory Commission (FERC) lacks the power to specifically require its supervised entities to make governance changes.¹⁴¹

Supervising agencies with oversight powers struggle to keep effective watch over SROs. Often, federal resources are simply spread too thin. Unsurprisingly, the SEC has failed to closely supervise SRO governance in the past.¹⁴² The SEC has also faced criticism for failing to identify any way of evaluating whether its supervision of an SRO was effective.¹⁴³

Supervising SROs presents a significant challenge for federal regulatory agencies because SROs differ significantly from each other, and their governance structures take many forms. There are three different versions to consider: SROs with public appointments and removal; nonprofit SROs without public appointments or removal; and corporate for-profit SROs.

1. Public Appointments & Removal

Although not the norm, some SROs have senior leadership directly appointed by public officials. For instance, PCAOB offers a relatively rare example of an SRO with senior leadership directly appointed by a public agency. The SEC appoints the members of the PCAOB's governing board after consulting with the Treasury and the Federal

140. *The Board*, PUB. CO. ACCT. OVERSIGHT BD., <https://pcaobus.org/about/the-board> [<https://perma.cc/PX6X-KFRG>] (explaining that “[t]he five members of the PCAOB Board . . . are appointed . . . by the Securities and Exchange Commission”).

141. *See* Cal. Indep. Sys. Operator Corp. v. FERC, 372 F.3d 395, 403–04 (D.C. Cir. 2004).

142. A 2012 Government Accountability Office Report found that the SEC had “conducted limited to no oversight of . . . FINRA’s . . . governance and executive compensation.” U.S. GOV’T ACCOUNTABILITY OFF., GAO-12-625, SECURITIES REGULATION: OPPORTUNITIES EXIST TO IMPROVE SEC’S OVERSIGHT OF THE FINANCIAL INDUSTRY REGULATORY AUTHORITY 7 (2012).

143. *See* U.S. GOV’T ACCOUNTABILITY OFF., GAO-15-376, SECURITIES REGULATION: SEC CAN FURTHER ENHANCE ITS OVERSIGHT PROGRAM OF FINRA 15 (2015).

Reserve.¹⁴⁴ When Congress created the PCAOB, it sought to protect its independence and insulate board members by providing that a “member of the Board may be removed by the Commission from office . . . for good cause shown before the expiration of the term of that member.”¹⁴⁵

Congress’s attempt to insulate PCAOB leadership from political control led to a constitutional problem because the Supreme Court believed it created two layers of protection for the PCAOB’s leadership.¹⁴⁶ First, the Supreme Court accepted the unclear proposition that cause was required to remove the SEC Commissioners.¹⁴⁷ Then, the Supreme Court declared the PCAOB’s “good cause” provision unconstitutional in *Free Enterprise Fund* because it believed the PCAOB’s leadership to be doubly insulated.¹⁴⁸ Writing for a divided Supreme Court, Chief Justice Roberts framed the core issue as whether the “President [may] be restricted in his ability to remove a principal officer, who is in turn restricted in his ability to remove an inferior officer, even though that inferior officer determines the policy and enforces the laws of the United States[.]”¹⁴⁹ Ultimately, the Supreme Court held that “such multilevel protection from removal is contrary to Article II’s vesting of the executive power in the President.”¹⁵⁰

2. Nonprofits Without Public Appointments or Removal

In contrast to the removal provisions held unconstitutional by the Supreme Court in *Free Enterprise Fund* and because it overly insulated SRO leadership from presidential control, most SROs select their own leadership without any public appointment process.¹⁵¹ In many instances, members of the SRO’s industry will elect a certain portion of the governing board, and the board itself will appoint additional “public”

144. See 15 U.S.C. § 7211(e)(4), *invalidated by* *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 492 (2010) (noting that the SEC “after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson and other initial members of the Board, and shall designate a term of service for each”).

145. *Id.* § (e)(6).

146. See *Free Enter. Fund*, 561 U.S. at 505 (reasoning that “the Sarbanes-Oxley Act is highly unusual in committing substantial executive authority to officers protected by two layers of for-cause removal”).

147. *Id.* at 486.

148. *Id.* at 484.

149. *Id.*

150. *Id.*

151. See, e.g., NAT’L FUTURES ASS’N, ARTICLES OF INCORPORATION art. VII, <https://www.nfa.futures.org/rulebook/rules.aspx?RuleID=ARTICLE%20VII&Section=2> [<https://perma.cc/8ZFD-W6EE>] (providing for a board of directors with a mix of industry and “public” representatives where the public representatives are selected by the existing board).

representatives to the board.¹⁵² Thus the only way for a person to join the board of directors without the approval of the existing board is to be voted onto the board through the industry election process. In theory, these board-appointed “public” representatives will counterbalance industry voices and encourage the SRO to act in favor of the public’s interest.¹⁵³ As an entity, the SRO is often simply organized as a nonprofit corporation.¹⁵⁴

Yet this type of appointment process has long been a concern because it allows the industry to have substantial influence over the “public” voice on the SRO’s board. Notably, the Massachusetts Securities Division argued in 2007 that FINRA would be “fundamentally flawed if the representatives of investors are chosen directly or indirectly by the securities industry or the current” self-regulatory associations.¹⁵⁵

Over time, this early concern proved prescient as SROs have drawn criticism for appointing industry members to Public Governor positions.¹⁵⁶ For example, one 2017 review found that FINRA’s “Public Governors often came to the posts after long industry careers at influential Wall Street firms.”¹⁵⁷ As recently as 2017, several of FINRA’s Public Governors simultaneously served on FINRA’s governing board

152. See Letter from Thomas W. Sexton, III, Vice President and Gen. Couns., Nat’l Futures Exch., to Jean A. Webb, Sec’y, Commodity Futures Trading Comm’n (Jan. 23, 2006) (on file with the National Futures Association) (stating that “NFA’s Board has always had public representatives, and their participation is an important protection for those market participants - primarily retail customers and other end users - who are not otherwise represented on NFA’s board”).

153. Edwards, *supra* note 10, at 585–86 (“A key premise underlies the decision to appoint to the board public representatives, who must bring something different to the board than industry members—otherwise their appointment would serve no purpose. Ideally, public representatives zealously guard the public’s interest and counterbalance industry influence within self-regulatory organizations.”).

154. See *About FINRA*, FINRA, <https://www.finra.org/about> [<https://perma.cc/5439-K2UR>] (“FINRA is a government-authorized not-for-profit organization that oversees U.S. broker-dealers.”).

155. Comment Letter from William F. Galvin, Sec’y, Commonwealth of Mass., to Nancy M. Morris, Sec’y, SEC (Apr. 18, 2007) (on file with the Commonwealth of Mass.), <https://www.sec.gov/comments/sr-nasd-2007-023/nasd2007023-73.pdf> [<https://perma.cc/5BUD-4JPV>] (“We specifically recommend that bodies like the North American Securities Administrators Association, the American Association of Retired Persons, and the Consumer Federation of America be among the investor advocates who select the Public Governors . . .”).

156. Susan Antilla, *Finance Execs Fill “Public” Board Seats at Finra, the Regulator That Promises Investor Protection*, STREET (Aug. 26, 2016, 9:31 AM), <https://www.thestreet.com/opinion/finance-execs-fill-public-board-seats-at-finra-the-regulator-that-promises-investor-protection-13684706> [<https://perma.cc/55ET-8UNZ>].

157. Andrew Stoltmann & Benjamin P. Edwards, *FINRA Governance Review: Public Governors Should Protect the Public Interest*, 24 PUB. INVS. ARB. BAR ASS’N BUS. J. 369, 382 (2017) (manuscript at 10), <https://piaba.org/system/files/2017-11/PIABA%20Report-%20FINRA%20Governance%20Report%20%28November%2015%2C%202017%29.pdf> [<https://perma.cc/H4NA-DD8G>].

and the boards of entities either overseen by FINRA or those distributing financial products through FINRA's member firms.¹⁵⁸ To its credit, FINRA has reduced the degree to which Public Governors concurrently serve on the boards of entities with subsidiaries overseen by FINRA.

The tendency to appoint industry members with significant industry connections as "public" representatives to SRO boards is not unique to FINRA. The NFA also appoints "public" members with significant industry connections.¹⁵⁹ Public Governors with some industry experience may be well-situated to understand and appreciate complex issues unique to their industry. Still, any court reviewing and considering the constitutional implications of an SRO's governing board should look past a simple "public" designation and seek to understand the extent to which "public" members have personal interests aligned with their SRO's industry.

FERC also supervises its own class of SROs, known as Regional Transmission Organizations (RTOs), which also operate as nonprofits.¹⁶⁰ These entities employ varied governance structures, but most design "a complex arrangement of shared power between an independent board and RTO members, who jointly hold power over a plethora of grid management decisions."¹⁶¹ California's RTO stands apart because California's governor appoints its governing board with approval from the senate.¹⁶² This unique governance structure, more akin to the PCAOB than to FINRA, may explain why California's RTO has more vigorously responded to the climate crisis than less publicly accountable RTOs.¹⁶³

Employing the SRO model for electric power likely entrenches existing market participants and drives negative externalities. One scholar explained that the SRO structure for governing the electric grid has led to heel-dragging in the face of the climate change crisis with voting power at RTOs being employed to "bias market rules" in favor of existing coal and natural gas infrastructure.¹⁶⁴

158. Benjamin Edwards & Andrew Stoltmann, *Financial Regulator's Conflicts of Interest are a Serious Concern*, HILL (Dec. 8, 2017, 1:00 PM), <https://thehill.com/opinion/finance/363941-financial-regulators-conflicts-of-interest-are-a-serious-concern> [<https://perma.cc/2YDV-C5NP>] (pointing out that multiple "public governors now take money from financial services firms" by serving on their boards of directors while simultaneously serving as public governors on FINRA's board).

159. See *Board of Directors*, NAT'L FUTURES ASS'N <https://www.nfa.futures.org/about/board-of-directors.html> [<https://perma.cc/CJQ8-NKG3>].

160. See Shelley Welton, *Rethinking Grid Governance for the Climate Change Era*, 109 CALIF. L. REV. 209, 227 n.105 (2021) (explaining that all but one RTO is organized as a nonprofit and the one that is not formally a nonprofit operates as one).

161. *Id.* at 228.

162. *Id.* at 229–30.

163. See *id.* at 268.

164. *Id.* at 241, 255.

3. Corporate For-Profit SROs

Although many SROs were once organized as cooperatives or private clubs, many now operate as for-profit corporations.¹⁶⁵ This organizational structure creates a conflict that a for-profit SRO's board must manage—balancing between the duties owed to shareholders of the corporation and their duties as an SRO.

Consider the complexities presented by the Intercontinental Exchange, Inc., a publicly traded company whose shares trade on the NYSE—one of multiple SROs it owns.¹⁶⁶ Its operations include twelve “regulated exchanges,” including five securities exchanges, six clearing houses, a broad variety of options and futures, as well as others.¹⁶⁷ CME Group, another for-profit corporation, also operates a significant number of exchanges.¹⁶⁸

Global markets depend on corporate for-profit SROs' steady functioning. ICE Clear Credit, an SRO and one of Intercontinental Exchange's subsidiaries, has been designated by the FSOC as a “systemically important financial market utility.”¹⁶⁹ This reflects FSOC's recognition that ICE Clear Credit's “failure of or a disruption” could create liquidity and credit problems of such a scale as to “threaten the stability of the financial system of the United States.”¹⁷⁰

A single private corporation may own many SROs and operate them subject to limited restrictions. The Intercontinental Exchange's shareholders elect its board of directors.¹⁷¹ Its annual report explains that no single person can cast more than ten percent of the votes on any matter.¹⁷² Similarly, because the Intercontinental Exchange owns SROs, no person may own “more than 20% of the then outstanding votes entitled to be cast on any matter” without express board and SEC approval.¹⁷³

165. Johnson, *supra* note 67, at 204 (“[E]xchanges and clearinghouses have traditionally been organized as cooperatives or private clubs.”).

166. Intercontinental Exchange, Inc., Annual Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934 for the Fiscal Year Ended December 31, 2020 (Form 10-K) 5 (Feb. 4, 2021), https://s2.q4cdn.com/154085107/files/doc_financials/2020/q4/ICE-4Q20-10K.pdf [<https://perma.cc/GZ35-PLUR>] (explaining that its business segments “includes the New York Stock Exchange and other registered securities exchanges”).

167. *Id.* at 5–6.

168. CME GROUP INC., ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES AND EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2020 (FORM 10-K) 5 (Feb. 26, 2021), <http://investor.cmegroup.com/static-files/74ff1d56-ab37-4631-b975-443ce75d19a5> [<https://perma.cc/4QLF-WWYR>] (describing its business operations).

169. Intercontinental Exchange, Inc., *supra* note 166, at 16.

170. 12 U.S.C. § 5462(9).

171. See Intercontinental Exchange, Inc., Notice of 2021 Annual Meeting and Proxy Statement 1, <https://d18rn0p25nwr6d.cloudfront.net/CIK-0001571949/79bd3461-0ff5-4810-b0e1-09477c01c034.pdf> [<https://perma.cc/4MJY-XF56>].

172. Intercontinental Exchange, Inc., *supra* note 166, ex. 4.26, at 1.

173. *Id.*

The board members controlling for-profit corporations that own SROs still owe duties to the corporation and to their shareholders. As a Delaware corporation, the duties owed by the Intercontinental Exchange's board of directors to the corporation and its shareholders are defined by Delaware law.¹⁷⁴ As one Delaware jurist explained, the directors of a Delaware for-profit corporation owe an obligation "to promote the value of the corporation for the benefit of its stockholders."¹⁷⁵

Operating SROs creates unique risks and complexities for private companies. The Intercontinental Exchange warns that owning and operating "exchanges exposes [private companies] to additional risks, including the regulatory responsibilities to which these businesses are subject."¹⁷⁶ Those risks and responsibilities include the need to enforce listed company compliance with SRO listing standards and the need to enforce compliance with SRO rules and the "*federal securities laws*."¹⁷⁷

For-profit SROs cannot simultaneously maximize shareholder value while exercising regulatory power in a way aimed at maximizing the public's interest and vigorously enforcing the federal securities laws.¹⁷⁸ Speaking candidly, the Intercontinental Exchange's annual report specifically explains that the "for-profit exchanges' goal of maximizing stockholder value might contradict the exchanges' regulatory and self-regulatory responsibilities."¹⁷⁹

D. *Nonconstitutional, Theoretical Justifications for SROs*

Different rationales have been offered to support delegating governmental authority to SROs. Whatever the merits of these positions, the reasons to support SRO structures generally have little to no bearing on their constitutional status.

1. Possible Taxpayer Savings

Using SROs as the primary regulators of their industries may result in taxpayer savings, depending on how such savings are calculated. One supporter of industry self-regulation explained that because SROs "are member-funded, . . . U.S. taxpayers . . . don't pay a dime for self-

174. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 26 (Del. Ch. 2010).

175. *Id.* at 34.

176. Intercontinental Exchange, Inc., *supra* note 166, at 24–25.

177. *Id.* (emphasis added).

178. See SEC, *supra* note 55, at 71,263 (recognizing as an inherent conflict "that the profit motive of a shareholder-owned SRO could detract from proper self-regulation").

179. Intercontinental Exchange, Inc., *supra* note 166, at 25.

regulation. The market participants themselves do.”¹⁸⁰ Generally, member firms pay fees to their SRO to support its operations and fund its oversight and enforcement of industry rules. Overseeing entire industries requires a significant amount of money. In 2021, the largest SRO, FINRA, budgeted to expend over \$1.1 billion and employ over 3,700 people—nearly as many as the SEC.¹⁸¹ If the SEC were to even attempt to directly assume all SRO responsibilities, it would require an enormous congressional spending authorization and would multiply the SEC’s budget and size.

The taxpayer savings rationale, as a justification for industry self-regulation, suffers from real weaknesses. Having an industry bear the financial burden of its own regulation does not require giving the industry control over its regulation. Congress could achieve the same effect and concentrate the cost of an industry’s regulation on the industry by creating a federal regulator with the authority to impose fees on the industry. The Fair Housing Finance Agency (FHFA) oversees critical parts of the housing industry and funds its operations from fees assessed on the entities it supervises.¹⁸² In 2020, the FHFA collected over \$300 million from the entities it oversaw.¹⁸³

Industry-funded self-regulation may also drive other costs for the general public, potentially well in excess of the purported taxpayer savings. Self-regulating industries have a strong incentive to shape developing industry rules in ways that maintain higher fees and transaction costs.¹⁸⁴ After all, the fees paid by the public create revenue for industries.¹⁸⁵

180. Heath P. Tarbert, Chairman & Chief Exec., Commodity Futures Trading Comm’n, Remarks of Chairman Heath P. Tarbert on Self-Regulation at Northwestern University’s Brodsky Family JD-MBA Lecture (Nov. 9, 2020), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opatarbert5> [<https://perma.cc/T957-MSLN>].

181. FINRA, FINRA 2021 ANNUAL BUDGET SUMMARY 5, 8 (2021), https://www.finra.org/sites/default/files/2021-05/2021_annual_budget_summary.pdf [<https://perma.cc/TNM8-QJRB>].

182. 12 U.S.C. § 4516(a) (directing that the FHFA “Director shall establish and collect from the regulated entities annual assessments in an amount not exceeding the amount sufficient to provide for reasonable costs (including administrative costs) and expenses of the Agency”).

183. See FED. HOUS. FIN. AGENCY, PERFORMANCE & ACCOUNTABILITY REPORT 24 (2020), <https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA-2020-PAR.pdf> [<https://perma.cc/S37G-V4RC>].

184. See Kathryn Judge, *Intermediary Influence*, 82 U. CHI. L. REV. 573, 577 (2015) (“[I]ntermediaries often have expertise and other strategic advantages that enable them to affect the processes through which institutions evolve in self-serving ways.”).

185. *Id.*

2. SRO Stability & Independent Funding

Stability and funding concerns provide other nonconstitutional justifications for industry self-regulation. SROs set their own fee levels and do not depend on the congressional appropriation process.¹⁸⁶ This also means that when the federal government shuts down because no appropriation has been passed, SROs continue to function without interruption. As a result, markets do not cease operating merely because the SEC had to furlough its staff during a government shutdown because Congress refused to authorize the SEC to spend funds.

3. Access to Superior Industry Expertise

Often, the SRO model draws support on the theory that regulators lack the depth of understanding necessary to efficiently regulate certain markets. In contrast, industry members have a ready depth of expertise and will not implement unworkable regulations because they lack understanding about the industry.¹⁸⁷

This rationale does not provide a constitutional justification for relying on SROs to enforce federal laws. Moreover, it calls into question the ability of federal administrative agencies to effectively oversee SROs. If federal regulators lack the necessary depth of expertise to understand markets, they cannot discern whether proposed SRO regulations operate in the public's interest or simply allow industry members to capture more transactional fees for themselves without any corresponding public benefit.

E. *Systemic Risk from Courts Disrupting SRO Functioning*

Our economic system depends on the steady functioning of many SROs. Federal law already recognizes that certain SROs serve as financial market utilities, meaning that their “failure of or a disruption” could create liquidity and credit problems of such a scale as to “threaten the stability of the financial system of the United States.”¹⁸⁸ As Supreme Court decisions may disrupt SRO functioning, the possibility of an adverse Supreme Court decision stands as a largely unappreciated systemic risk to the global economy.

186. Tarbert, *supra* note 180 (“SROs avoid the appropriations process, and that’s really important because when your appropriations for a regulator are subject to budgets, to larger political questions, to members of Congress having to vote for it, oftentimes you end up with uneven funding and uncertainty.”).

187. See Birdthistle & Henderson, *supra* note 7, at 55 (“[T]he greatest single benefit that self-regulation possesses . . . is its access to direct industry expertise.”).

188. 12 U.S.C. § 5462(9).

Systemic risk can be challenging to precisely define.¹⁸⁹ The term is ordinarily understood to describe some disruption creating a domino effect of adverse economic consequences, materially impairing markets.¹⁹⁰ These risks can originate from either inside or outside of the financial system. For example, the 2008–2009 financial crisis came from within the financial system, driven by defaults on subprime mortgages.¹⁹¹

Systemic risk may also be understood as something that disrupts either critical financial institutions or markets.¹⁹² In the SRO context, the Supreme Court poses systemic risk both to SROs as financial institutions and markets.

1. Potential Direct Disruption to Financial Institutions

An adverse Supreme Court decision invalidating some SRO rule or activity could directly disrupt critical financial institutions if it interferes with an SRO's ability to continue ordinary operations. Although the precise details of these challenges will vary, a challenge to a financial market utility could immediately destabilize markets. Consider the critical role played by one SRO—the Depository Trust and Clearing Corporation (DTCC). DTCC subsidiaries include multiple systemically important clearing firms.¹⁹³ If a market participant successfully challenged a clearing firm decision on the ground that the clearing firm rules were unconstitutional, markets may cease to function. If clearing firms were not able to clear trades, enormous downstream consequences would ensue. People would not be able to buy or sell securities or derivatives. Consequentially, all of the wealth stored within these financial products would become suddenly inaccessible.

Although this type of decision appears unlikely in the near term, its possibility illustrates how some judicial decision disrupting SRO functioning could immediately shut down markets and drive disastrous economic consequences. The point is not that judicial disruption to a financial institution is likely to happen in any particular way but that the risk of a judicial decision disrupting a systemically important financial institution exists.

How much disruption a decision will cause may not be clear beforehand. Our financial system operates through a series of

189. Barnali Choudhury, *Climate Change as Systemic Risk*, 18 BERKELEY BUS. L.J. 52, 57 (2021) (“Systemic risk lacks a widely accepted definition.”).

190. *Id.*

191. *Id.*

192. Schwarcz, *supra* note 11, at 198–201.

193. See Paolo Saguato, *The Ownership of Clearinghouses: When “Skin in the Game” Is Not Enough, the Remutualization of Clearinghouses*, 34 YALE J. ON REGUL. 601, 612–13 (2017) (describing systemically important clearinghouses).

interconnected financial intermediaries.¹⁹⁴ A court decision disrupting a deeply connected SRO will likely generate consequences for all its connections. As the effects of a disruption ripple outward, a disruption to one SRO or a piece of market infrastructure may cause a particular asset's price to crash.¹⁹⁵

As there may be no good way to statistically forecast the likelihood of a Supreme Court decision directly disrupting a systemically important SRO, the situation may involve Knightian uncertainty. This means that probabilities simply cannot presently be assigned to the likelihood of this type of imaginable event.¹⁹⁶

Still, this does not mean that the risk should be ignored. Given the tremendous size of the potential harm, any relatively modest measure to mitigate the risk with no or limited downside should be carefully considered.

2. Potential Market Disruption

The Supreme Court may also disrupt markets by invalidating some SRO rules or their structures. This type of market disruption may be much more likely to occur because the event triggering a market disruption may not be readily foreseeable by Supreme Court Justices. Consider the risks flowing from a challenge to rules issued by the MSRB.¹⁹⁷ MSRB Rule G-30 prohibits brokers and securities dealers from buying or selling a municipal security "except at an aggregate price (including any mark-up or mark-down) that is fair and reasonable."¹⁹⁸ A brokerage penalized under this rule might raise constitutional objections about the rule's vagueness and contend that they should be able to freely buy and sell municipal securities at prices their customers willingly accept. If the Supreme Court invalidated the rule and much of the MSRB's authority, it would raise significant questions about other MSRB rules, including those governing the initial offering of municipal securities. Banks might reasonably suspend or dramatically restrict municipal securities issuance for a time to resolve the legal uncertainty about such offerings in the aftermath of such a decision.

194. Tom C.W. Lin, *Infinite Financial Intermediation*, 50 WAKE FOREST L. REV. 643, 661 (2015) ("If the financial network is the ultimate intermediary, then every link in that network may be crucial to its stability.").

195. For example, a temporary outage for Bloomberg terminals once disrupted bond markets. Nathaniel Popper & Neil Gough, *Bloomberg Data Crash Puts Market in Turmoil*, N.Y. TIMES, Apr. 18, 2015, at B1.

196. See Cass R. Sunstein, *Maximin*, 37 YALE J. ON REGUL. 940, 944 (2020) (describing Knightian uncertainty).

197. Municipal securities are often bonds issued by states and local governments.

198. MUN. SEC. RULEMAKING BD., RULE G-30(A) (May 14, 2018), <https://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30> [<https://perma.cc/7WAB-ESZA>].

This type of market disruption could have catastrophic consequences. In 2020 alone, the U.S. municipal bond market issued over \$484 billion in long-term municipal bonds.¹⁹⁹ If municipalities could not obtain capital through these new bond offerings, they might default on existing, expiring bonds. Widespread bond defaults could trigger large insurance payments, thus potentially bankrupting insurance companies. State and local governments in need of capital to fund their operations in advance of tax revenues might either not be able to obtain them to pay wages or be forced to accept such unfavorable terms, forcing them to lay off employees. In short, the potential economic damage from a market disruption would be enormous.

A Supreme Court decision invalidating an SRO rule, risks triggering a cascade of market consequences. These risks may be particularly pronounced for SRO rules connected to securities offering processes. The sudden invalidation of one of these rules could suspend much of the activity within capital markets, leading to significantly broader economic problems.

Critically, the U.S. economy largely depends on the smooth functioning of capital markets. In 2020 alone, U.S. capital markets issued over \$12 trillion in fixed income products, including mortgage-backed securities, corporate bonds, treasury securities, municipal bonds, and asset-backed securities, among others.²⁰⁰ Equity issuances in 2020 totaled at \$390 billion.²⁰¹ Any disruption to these markets could drive a cascade of economic problems.

II. LOOMING CONSTITUTIONAL QUESTIONS FOR THE SRO MODEL

Recent judicial decisions and changes in the composition of the Supreme Court amplify the risk that federal courts may declare the SRO model unconstitutional. The constitutional risks now faced by SROs come from a variety of constitutional quarters grouped into four categories for this Article: nondelegation doctrine risks; separation of powers risks; state action risks; and Appointments Clause risks.

Although this Article highlights the risks that these doctrines pose, it does not attempt to definitively resolve these questions or provide a perfectly balanced depiction on the relative merits of each doctrine. Entire law review articles have been written about each of these doctrines—generally with no attention to what these doctrines mean for SROs. As SROs remain most prominent in financial regulation, constitutional and administrative law scholars rarely discuss them.

199. SEC. INDUS. & FIN. MKTS. ASS'N, 2021 CAPITAL MARKETS FACT BOOK 8 (July 2021), <https://www.sifma.org/wp-content/uploads/2021/07/CM-Fact-Book-2021-SIFMA.pdf> [<https://perma.cc/Y9JW-7G9V>].

200. *Id.*

201. *Id.*

Sketching these risks underscores the present need to thoughtfully plan for the way that financial regulation will endure and ensure smooth market functioning if courts decide to roll back SRO authority and reach.

In discussing these doctrines and arguments, this Article does not focus on whether the Supreme Court would be correct to declare SROs unconstitutional or otherwise limit their reach. Indeed, many of these doctrines and arguments have been roundly criticized. Instead, this Article takes the doctrines as the Supreme Court has stated them and extends them to highlight the real and foreseeable risks emerging from these doctrines. Ultimately, some judicial intervention into the SRO model seems reasonably likely simply because of the awkward middle ground between business and government now occupied by SROs.

A. *Nondelegation Doctrine Risks*

Putting the hot disputes over the nondelegation doctrine's existence and precise reach to the side, the doctrine can be summarized in a general way. The nondelegation doctrine limits Congress's ability to delegate its legislative powers and cedes the right to make "legislative" decisions to others.²⁰² Proponents of the doctrine point to the Constitution's Vesting Clause in Article I, which provides that "[a]ll legislative powers herein granted shall be vested in a Congress of the United States."²⁰³ This Clause has been interpreted as anchoring the legislative power with Congress and limiting Congress's ability to delegate it away.²⁰⁴

Many conservative and originalist jurists have increasingly turned to the nondelegation doctrine in their opinions.²⁰⁵ There will likely be many more nondelegation challenges and decisions to come because an expanded nondelegation doctrine could force a conclusion, as Justice Elena Kagan observed, that "most of Government is unconstitutional—dependent as Congress is on the need to give discretion to executive officials to implement its programs."²⁰⁶ Although the shoe has not yet dropped, a majority of today's Supreme Court has signaled an interest in revisiting and possibly expanding the doctrine.²⁰⁷

202. See Eric A. Posner & Adrian Vermeule, *Interring the Nondelegation Doctrine*, 69 U. CHI. L. REV. 1721, 1721 (2002).

203. U.S. CONST. art. I, § 1.

204. See Alexander Volokh, *The Shadow Debate over Private Nondelegation in DOT v. Association of American Railroads*, 2015 CATO SUP. CT. REV. 359, 360 ("[T]he Supreme Court agrees with the soundness of the doctrine in principle and has long accepted the nondelegation reading of the Vesting Clause . . .").

205. See, e.g., *Texas v. Rettig*, 993 F.3d 408, 409 (5th Cir. 2021) (Ho, J., dissenting) ("[Constitutional] provisions do not permit Congress to delegate its lawmaking powers elsewhere, any more than they permit the President to delegate the power to sign legislation.").

206. *Gundy v. United States*, 139 S. Ct. 2116, 2130 (2019).

207. See *Coney Barrett*, *supra* note 46, at 265 (noting that "the constitutionality of delegation . . . is not likely immune from judicial review").

However, sketching the boundaries of the nondelegation doctrine presents a real difficulty because opinions vary widely about the doctrine. Some opinions claim the doctrine does not exist.²⁰⁸ Other opinions contend that the Founders saw no limit on Congress's ability to delegate power.²⁰⁹ Yet another opinion provides that "evidence of Founding-era political thought and practice is overwhelmingly in favor of a nondelegation doctrine at the Founding."²¹⁰

Although expanding the nondelegation doctrine poses a risk to SROs and administrative agencies generally, the private nondelegation doctrine poses a particular and heightened risk to SROs. It prohibits Congress from delegating its legislative powers to create binding law to a *private* organization.²¹¹ This restriction, if applied to SROs, would entirely prohibit using the SRO model to regulate vast industries.²¹²

1. General Nondelegation Doctrine

Establishing the contours of the nondelegation doctrine remains difficult. The Supreme Court has a history of stating that "Congress cannot delegate legislative power to the President."²¹³ At the same time, the Supreme Court has said that Congress may task the executive branch with implementing statutes.²¹⁴ The nondelegation doctrine draws the line between merely implementing that which Congress directed the executive to do and that which Congress may not impermissibly delegate.

The nondelegation doctrine's high-water mark came in 1935 when the Supreme Court struck down two New Deal-era provisions included in the National Industrial Recovery Act.²¹⁵ In *Panama Refining Co. v. Ryan*,²¹⁶ the Court declared a provision allowing the President to set quotas on how much oil could be transported unconstitutional.²¹⁷ Similarly, in

208. See Posner & Vermeule, *supra* note 202, at 1721 ("[W]e argue that there is no such nondelegation doctrine . . .").

209. Julian Davis Mortenson & Nicholas Bagley, *Delegation at the Founding*, 121 COLUM. L. REV. 277, 332 (2021) ("Regulatory delegations were limited only by the will and judgment of the legislature.").

210. Ilan Wurman, *Nondelegation at the Founding*, 130 YALE L.J. 1490, 1556 (2021).

211. See *Carter v. Carter Coal Co.*, 298 U.S. 238, 311 (1936) (opining that legislative delegation to a private party is the "most obnoxious form" of delegation).

212. See Hammond, *supra* note 1, at 1721–22.

213. See *Marshall Field & Co. v. Clark*, 143 U.S. 649, 692 (1892) ("[C]ongress cannot delegate legislative power to the President . . .").

214. *E.g.*, *Gundy v. United States*, 139 S. Ct. 2116, 2123 (2019) ("Congress may 'obtain[] the assistance of its coordinate Branches'—and in particular, may confer substantial discretion on executive agencies to implement and enforce the laws." (quoting *Mistretta v. United States*, 488 U.S. 361, 372 (1989))).

215. See *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 541–42 (1935); *Panama Refin. Co. v. Ryan*, 293 U.S. 388, 430 (1935).

216. 293 U.S. 388 (1935).

217. *Id.* at 430.

A.L.A. Schechter Poultry Corp. v. United States,²¹⁸ the Court struck down a provision granting the President power to approve “codes of fair competition” generated by trade associations on worker hours, minimum wages, and other issues such as how live poultry may be sold.²¹⁹

These two major nondelegation doctrine decisions came at a time when the Supreme Court had been sharply limiting congressional power to regulate interstate commerce.²²⁰ When the Supreme Court reversed its course on the Commerce Clause in *NLRB v. Jones & Laughlin Steel Corp.*,²²¹ the nondelegation doctrine largely receded as well, despite the doctrine’s analytical distinction from commerce clause analysis.²²² The Supreme Court has mostly left the nondelegation doctrine slumbering since that time. In 2000, Professor Cass Sunstein described the nondelegation doctrine as having had “one good year, and 211 bad ones (and counting).”²²³

For the most part, delegations of legislative authority have been upheld following *J.W. Hampton, Jr. & Co. v. United States*.²²⁴ In essence, all that is required for a court to uphold the delegation of legislative power is for Congress to prescribe an “intelligible principle” to guide regulation.²²⁵ At times, the Court has upheld even seemingly vague “intelligible principle[s]” such as the “requisite to protect the public health,” which serves as the statutorily articulated, intelligible principle guiding regulation under the Clean Air Act.²²⁶

But the doctrine appears poised for a resurgence. Professors Julian Davis Mortenson and Nicholas Bagley recently warned that the doctrine’s “reinvigoration would mark a radical break with constitutional practice and could entail the wholesale repudiation of modern American governance.”²²⁷ For years, conservative and originalist scholars contended that nondelegation doctrines should play a more expansive role in shaping government structure.²²⁸ Second Circuit Judge Douglas H. Ginsburg described the nondelegation doctrine as “banished for

218. 295 U.S. 495 (1935).

219. *Id.* at 535, 541–42.

220. Mortenson & Bagley, *supra* note 209, at 284.

221. 301 U.S. 1 (1937).

222. *Id.* at 36–37; Mortenson & Bagley, *supra* note 209, at 284.

223. Cass R. Sunstein, *Nondelegation Canons*, 67 U. CHI. L. REV. 315, 322 (2000).

224. 276 U.S. 394, 409 (1928).

225. *Id.*

226. *Whitman v. Am. Trucking Ass’ns*, 531 U.S. 457, 473–76 (2001).

227. Mortenson & Bagley, *supra* note 209, at 278.

228. See Gary Lawson, *Delegation and Original Meaning*, 88 VA. L. REV. 327, 335 (2002) (“[T]hose who reject a meaningful nondelegation doctrine . . . should not pretend to speak in the name of the Constitution.”).

standing in opposition to unlimited government.”²²⁹ He noted that the memory of the doctrine is “kept alive by a few scholars who labor on in the hope of a restoration.”²³⁰

The odds of the nondelegation doctrine resurging in some form have increased with new Trump-era appointments to the Supreme Court joining existing conservative Justices. Justice Samuel Alito recently signaled his willingness to revisit the existing nondelegation doctrine in *Gundy v. United States*²³¹ so long as a majority of Justices could be assembled to reconsider the doctrine.²³² Justice Neil Gorsuch, joined by Chief Justice Roberts and Justice Clarence Thomas, would have struck the statute down as delegating too much policymaking power to the executive.²³³ Although he did not participate in *Gundy*, Justice Kavanaugh later signaled that he would support reconsidering the existing nondelegation doctrine.²³⁴

A revitalized nondelegation doctrine could create trouble for financial regulators generally and the SRO regulatory model, particularly. Consider the statutory provision allowing the SEC to require nonmembers to comply with securities exchanges’ rules. The statute provides that the SEC may order, “as it deems necessary or appropriate in the public interest and for the protection of investors,” that nonmembers comply with exchange rules.²³⁵ There are many similar provisions scattered throughout the securities laws enabling the SEC or SROs to act or make rules “in the public interest.”²³⁶ The SEC may even amend SRO rules whenever it believes an amendment would be “in furtherance of the purposes of” the statutory chapter.²³⁷ Whether “in the public interest and for the protection of investors” or to advance “statutory purposes” will suffice as an intelligible principle will depend on how the Supreme Court frames the nondelegation doctrine going forward. If the Supreme Court narrows the range of permissible

229. Douglas H. Ginsburg, *Delegation Running Riot*, 18 REGUL. 83, 84 (1995) (reviewing DAVID SCHOENBROD, *POWER WITHOUT RESPONSIBILITY: HOW CONGRESS ABUSES THE PEOPLE THROUGH DELEGATION* (1993)), <https://www.cato.org/sites/cato.org/files/serials/files/regulation/1995/1/v18n1-9.pdf> [<https://perma.cc/8TFR-GHRS>].

230. *Id.*

231. 139 S. Ct. 2116 (2019).

232. *Id.* at 2131 (Alito, J., concurring) (“If a majority of this Court were willing to reconsider the approach we have taken for the past 84 years, I would support that effort.”).

233. *Id.* (Gorsuch, J., dissenting).

234. *See* Paul v. United States, 140 S. Ct. 342, 342 (2019) (mem.) (Kavanaugh, J., respecting the denial of certiorari) (stating that Justice Gorsuch’s “scholarly analysis of the Constitution’s nondelegation doctrine in his *Gundy* dissent may warrant further consideration in future cases”).

235. 15 U.S.C. § 78f(f).

236. *See, e.g., id.* § 78o-11(c)(1)(G); *id.* § 78o-9(d)(1); *id.* § 78q-1(b)(2).

237. *Id.* § 78s(c).

delegations, SROs and other financial regulators may lose substantial authority.

2. The Private Nondelegation Doctrine & SROs

As generally understood, the private nondelegation doctrine differs from the more general nondelegation doctrine in that it turns on the recipient of Congressional legislative power. While some delegations to government agencies might pass muster under the nondelegation doctrine, giving the same authority to a private person may violate the Constitution.

Understanding the private nondelegation doctrine's threat to SROs requires an understanding of its history. The doctrine originated in *Carter v. Carter Coal Co.*²³⁸ Congress passed a statute authorizing the creation of district boards to set minimum prices for coal.²³⁹ To encourage participation in the regulatory regime, Congress also enacted a tax that would apply to anyone opting out of the coal-pricing regulatory regime.²⁴⁰ The regime called for industry boards, comprised of significant producers and mine workers, to control maximum hours and to set minimum prices.²⁴¹ In many ways, this arrangement appears remarkably similar to the SRO model allowing industry groups to regulate themselves.

The Supreme Court declared the arrangement unconstitutional because it conferred power on the majority of coal producers and miners—acting through the industry board—to regulate the minority.²⁴² An oft-quoted portion of the decision described this arrangement as “legislative delegation in its most obnoxious form.”²⁴³ It explained that it was an unconstitutional delegation “to private persons whose interests may be and often are adverse to the interests of others in the same business.”²⁴⁴ The Supreme Court described this arrangement as an “unconstitutional interference with personal liberty and private property,” “clearly arbitrary,” and “a denial of rights safeguarded by the due process clause of the Fifth Amendment.”²⁴⁵

Although the decision has been classified by others as part of the general *Lochner*-era line of commerce clause cases, this is not the best

238. 298 U.S. 238 (1936).

239. *Id.* at 282.

240. *Id.* at 289 (explaining that the purpose of the “tax” was “to coerce what is called an agreement—which, of course, it is not One who does a thing in order to avoid a monetary penalty does not agree; he yields to compulsion precisely the same as though he did so to avoid a term in jail.”).

241. *Id.* at 310–11.

242. *Id.* at 311.

243. *Id.*

244. *Id.*

245. *Id.*

reading.²⁴⁶ One scholar recently explained that the decision is best “understood as a constitutionally rooted concern about fundamental fairness.”²⁴⁷ Allowing self-interested private groups to enforce their will as law on others goes directly to fundamental fairness concerns.²⁴⁸

This concern about whether granting federal power to private actors is fundamentally fair remains today. About a decade ago, the D.C. Circuit applied the private nondelegation doctrine to declare a statute delegating power to Amtrak unconstitutional.²⁴⁹ On appeal, the Supreme Court reversed and remanded the decision, finding that Amtrak was a federal actor, thus removing the concern under the private nondelegation doctrine about delegating power to Amtrak.²⁵⁰

Justice Alito concurred with the decision in *Department of Transportation v. Association of American Railroads*²⁵¹ but went on to criticize another apparent violation of the private nondelegation doctrine within the statute.²⁵² A provision of the statute calls for an arbitrator to decide if the Federal Railroad Administration and Amtrak are in deadlock over regulatory standards.²⁵³ Justice Alito declared that if the arbitrator might be a private person, the law would be unconstitutional because a private person would be setting regulatory standards by adjudicating the dispute.²⁵⁴

Justice Alito’s concern about a private arbitrator settling disputes between government branches invoked the private nondelegation doctrine. He raised the possibility that the structure might allow government officials to “wield power without owning up to the consequences . . . by passing off a Government operation as an independent private concern.”²⁵⁵

The SRO model also implicates these concerns. In both instances, Congress entrusts federal power to private organizations to make rules governing their industries. SROs generally operate free from constitutional constraints as private organizations, yet government agencies often retain the power to shape and control their rules.

246. See, e.g., Edward Cantu, *Seila Law as Separation-of-Powers Posturing*, 110 GEO. L.J. ONLINE 38, 42 (2021) (describing *Carter Coal* as the Supreme Court acting with “uncompromising formalism [to strike down] federal laws passed pursuant to the Commerce Clause”).

247. See Hammond, *supra* note 1, at 1722.

248. *Id.* at 1722–23.

249. *Ass’n of Am. R.Rs. v. U.S. Dep’t of Transp.*, 721 F.3d 666, 677 (D.C. Cir. 2013), *vacated*, 575 U.S. 43 (2015).

250. See *Ass’n of Am. R.Rs.*, 575 U.S. at 44.

251. 575 U.S. 43 (2015).

252. *Id.* at 56–57 (Alito, J., concurring).

253. *Id.* at 59–60.

254. *Id.* at 60–61.

255. *Id.* at 57.

Moreover, the SEC may even use its power to amend an SRO's rules with the statute deeming an SEC-enacted SRO rule "to be part of the rules of [the SRO] and . . . not . . . considered to be a rule of the [SEC]."²⁵⁶

Yet SRO-style delegations have thus far escaped the private nondelegation doctrine. In response to *Carter Coal*, Congress directed industry groups to "propose" coal prices to a federal agency.²⁵⁷ The agency would then approve, disapprove, or otherwise modify the proposal.²⁵⁸ In *Sunshine Anthracite Coal v. Adkins*,²⁵⁹ the Supreme Court approved this new arrangement.²⁶⁰ The Court found that Congress had not "delegated its legislative authority to the industry" because the industry boards "function subordinately to the Commission."²⁶¹ This arrangement passed muster because the federal agency held ultimate approval power.²⁶² The Supreme Court embraced the same reasoning in *Currin v. Wallace*,²⁶³ where federal regulations would only become effective if two-thirds of tobacco growers voted in favor of it.²⁶⁴ A federal regulator created the regulations, leaving the industry vote as a mere procedural hurdle.

Functionally, the private nondelegation doctrine is dead letter as long as some federal agencies retain formal oversight power.²⁶⁵ Even though audited SROs wield vast power, they meet this requirement because federal agencies retain the ability to approve or disapprove SRO rulemaking and to review their adjudications.

A Supreme Court more concerned about excessive delegations of legislative power to private entities might revisit this highly deferential approach. As Professor Emily Hammond explained, this formalistic approach does not speak to the kind of oversight that should be required or "whether the oversight is sufficient to guard against arbitrariness or promote accountability."²⁶⁶

The Supreme Court might view oversight differently depending on how an SRO proposal goes into effect. SRO rule proposals go into effect in different ways. The SEC may affirmatively approve or disapprove

256. 15 U.S.C. § 78s(c)(4)(C).

257. *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 388 (1940) (describing the scheme).

258. *Id.*

259. 310 U.S. 381 (1940).

260. *Id.* at 404.

261. *Id.* at 399.

262. *Id.*

263. 306 U.S. 1 (1939).

264. *Id.* at 15 ("Congress has merely placed a restriction upon its own regulation by withholding its operation as to a given market 'unless two-thirds of the growers voting favor it.'").

265. See Hammond, *supra* note 1, at 1728 ("[C]ases reflect an on-off approach that asks only whether the privatization at issue is subject to formal oversight by a federal agency.").

266. *Id.*

many rule proposals. If the SEC fails to affirmatively disapprove of or respond to a rule proposal after a set period, the statute deems the SEC to have approved the rule proposal.²⁶⁷ Some rule proposals become immediately effective upon filing if the SRO characterizes them as meeting particular criteria, such as interpreting an existing SRO rule, modifying fees, or involving the administration of the SRO.²⁶⁸ Of course, the SEC retains the power to immediately suspend effective rules afterward if it deems such action necessary.²⁶⁹

A private nondelegation doctrine challenge to SROs, rooted in due process principles, might also attract a majority of the current Supreme Court. Notably, the modern SROs, overseen by the SEC, operate under a different regulatory framework than they did in the New Deal era. The SEC now has the power to amend SRO rules on its own.²⁷⁰ A due process challenge might succeed by focusing on the impropriety of allowing a federal authority to shed its restraints and regulate through a private entity.²⁷¹

B. *Separation of Powers Risks*

In recent years, the Supreme Court has increasingly applied separation of powers principles to find various facets of the administrative agency design unconstitutional.²⁷² Although not explicitly articulated in the Constitution, separation of powers principles arise from the Constitution's structure situating different powers within different branches of government.²⁷³ Notably, the Constitution places "[t]he executive Power . . . in a President of the United States of America," directing the President to "take Care that the Laws be faithfully executed."²⁷⁴

To protect the President's ability to ensure faithful execution of the laws, the Supreme Court issued several decisions invalidating the administrative agency structures that overly insulate the heads of

267. 15 U.S.C. § 78s(b).

268. *Id.*

269. *Id.*

270. *See supra* Section I.A.

271. *See* Paul J. Larkin, Jr., *The Private Delegation Doctrine*, 73 FLA. L. REV. 31, 75 (2021) ("The Due Process Clause protects the public against the federal government's attempt to shed those rules by delegating power to private parties, whether individuals or corporations.").

272. *See* Kristin E. Hickman, *Symbolism and Separation of Powers in Agency Design*, 93 NOTRE DAME L. REV. 1475, 1476 (2018) ("Administrative law has seen several cases in recent years focused on agency design and separation of powers principles.").

273. *See* Metro. Wash. Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc., 501 U.S. 252, 272 (1991) (explaining that the Framers "disperse[d] the federal power among the three branches—the Legislative, the Executive, and the Judicial—placing both substantive and procedural limitations on each").

274. U.S. CONST. art. II, §§ 1, 3.

administrative agencies from presidential control. As most SROs entirely control their own personnel without any line of appointment to the federal executive, these decisions have increased the degree of uncertainty about modern SROs.

A substantial body of caselaw discusses the need to ensure that the President retains an appropriate degree of administrative control over the persons enforcing federal law by preserving the presidential power to remove officials.²⁷⁵ For instance, in *Myers v. United States*,²⁷⁶ the Supreme Court recognized that the President must have the power to remove senior executive branch officials to maintain control over the government.²⁷⁷ Since that time, only a few exceptions to this general rule have been affirmed by the Supreme Court.

Independent federal administrative agencies have been somewhat insulated from presidential removal power through for-cause removal provisions. The Supreme Court first approved a statute providing officials at a multimember, independent agency with for-cause removal protection in *Humphrey Executor v. United States*²⁷⁸ in 1935.²⁷⁹ For decades, the precedent had been understood to authorize for-cause removal protections for the heads of independent agencies.

In recent years, the Supreme Court has rendered opinions limiting the conditions under which an independent agency may be insulated from executive control. In 2020, the Supreme Court revisited the issue in *Seila Law LLC v. Consumer Financial Protection Bureau*, and declared the for-cause removal protection provided to the Bureau's head unconstitutional.²⁸⁰ Writing for the Court, Chief Justice Roberts ruled that the Consumer Financial Protection Bureau's (CFPB) for-cause removal protections were unconstitutional because, unlike the other multimember executive agencies, the CFPB wields "significant executive power and is run by a single individual."²⁸¹ The Court found the structure unconstitutional because it overly inhibited the President's ability to ensure the faithful execution of the law.²⁸² The Court treated the limitation as severable from the rest of the statute and left the CFPB otherwise intact.

275. See generally *Myers v. United States*, 272 U.S. 52 (1926) (ruling that the president has the power to remove executive branch officials).

276. 272 U.S. 52 (1926).

277. *Id.* at 134–35.

278. 295 U.S. 602 (1935).

279. *Id.* at 629.

280. 140 S. Ct. 2183, 2192 (2020).

281. *Id.*

282. *Id.* at 2204.

1. Implications for SROs from *Collins v. Yellen*

A year after the *Seila Law* opinion was released, the Court used the same reasoning in *Collins v. Yellen* and struck down another for-cause removal protection for the single director head of the FHFA.²⁸³ Increasing the danger to SROs, the Court explained that the President’s “removal power serves vital purposes even when the officer subject to removal is not the head of one of the largest and most powerful agencies.”²⁸⁴ Justice Alito’s majority opinion also stressed that the President must maintain a “degree of control” over subordinates, and that the removal power works to ensure that subordinates “serve the people effectively and in accordance with the policies that the people presumably elected the President to promote.”²⁸⁵ Notably, the reasoning in *Collins* explicitly rejected a number of possible distinctions which might have been used to save an SRO facing a constitutional challenge.

a. Size & Scope Immaterial

The Court in *Collins* specifically rejected attempts to distinguish the FHFA from the CFPB based on its size and scope.²⁸⁶ While the CFPB regulates a broad range of consumer financial products and affects purely private individuals, the FHFA only directly oversees a limited range of government-sponsored entities. This distinction did not matter in *Collins*. Justice Alito, writing for the majority, explained that courts should not “weigh the relative importance of the regulatory and enforcement authority of disparate agencies,” and that the Court did “not think that the constitutionality of removal restrictions hinges on such an inquiry.”²⁸⁷ This language may make it more difficult for SROs to distinguish themselves by situating themselves as playing narrow roles.

b. Rejecting Public/Private Distinctions

Creating even more danger for SROs, Justice Alito also rejected a proposed public/private distinction. An amicus argued that by acting as a receiver, the FHFA stepped into the shoes of a private entity, thus not wielding executive power.²⁸⁸ Justice Alito rejected this distinction with language directly relevant to SROs. He explained that when the FHFA decides “what it must do, what it cannot do, and the standards that govern

283. *Collins v. Yellen*, 141 S. Ct. 1761, 1784 (2021) (“A straightforward application of our reasoning in *Seila Law* dictates the result here.”).

284. *Id.*

285. *Id.*

286. *Id.* at 1785.

287. *Id.*

288. *Id.*

its work,” it necessarily interprets federal statutes.²⁸⁹ Quoting *Bowsher v. Synar*, 478 U.S. 714 (1986). Justice Alito found that “interpreting a law enacted by Congress to implement the legislative mandate is the very essence of ‘execution’ of the law.”²⁹⁰

Justice Alito’s reasoning creates real risks for SROs because they also interpret laws enacted by Congress. Under this standard, the Intercontinental Exchange and similar SROs execute the law because they must enforce compliance with the provisions of the Exchange Act and a range of other rules and regulations.²⁹¹ This means that longstanding, SRO-led enforcement efforts may face a new degree of constitutional scrutiny because they require SROs to interpret and implement federal law. SROs charged with enforcing federal law may now struggle to use their private status to avoid constitutional issues.

c. Rejecting “Indirect” Regulation Arguments

Justice Alito also rejected an attempt to distinguish the FHFA from the CFPB on the ground that it only regulated a narrow class of special entities.²⁹² Justice Alito, in rejecting this distinction, explained that the “President’s removal power serves important purposes regardless of whether the agency in question affects ordinary Americans by directly regulating them or by taking actions that have a profound but indirect effect on their lives.”²⁹³

In a future case, SROs might seek to differentiate themselves by pointing out that their regulations and oversight primarily affect their members and not the general public. Justice Alito’s opinion recognized that, even if specialized business entities are the direct and primary targets of regulation, regulatory decisions go on to affect ordinary people. For example, consider the SROs overseeing electric grids. Their decisions about the types of infrastructure to develop and maintain has a significant impact on ordinary people. Similarly, decisions about how to enforce federal law for financial services firms have a significant impact on the types of services provided to ordinary retail investors.

d. Split over Relief

The Supreme Court’s conservative majority split over whether the FHFA’s prior actions were lawful because its director held office under the protection of an unconstitutional provision. The majority, including Justice Alito, simply remanded the question to evaluate whether the

289. *Id.*

290. *Id.* (quoting *Bowsher v. Synar*, 478 U.S. 714, 733 (1986)).

291. *Intercontinental Exchange, Inc.*, *supra* note 166, at 16–17.

292. *Collins*, 141 S. Ct. at 1786.

293. *Id.*

unconstitutional for-cause removal provision caused any compensable harm.²⁹⁴

Justice Gorsuch's concurrence charted a different path and indicated that he would have declared all the FHFA's director's prior acts void.²⁹⁵ He speculated that the majority may have been hesitant to award relief because "affording a more traditional remedy here could mean unwinding or disgorging hundreds of millions of dollars that have already changed hands."²⁹⁶

If the constitutionality of an SRO reaches the Supreme Court, *Collins* shows the difficulty the Court will face in awarding relief. Declaring the SROs prior acts unlawful will likely be unappealing because it might unwind trillions of dollars in transactions. Remanding the issue to lower courts would also likely launch a flood of litigation if nonparties rush to court to unwind transactions. If the Supreme Court followed the path Justice Gorsuch advocated for and voided a critical SRO, it would likely trigger a financial crisis.

2. Office of Legal Counsel Extends *Collins*

After *Collins*, the Justice Department's Office of Legal Counsel issued an opinion applying the decision to the head of the Social Security Administration (SSA).²⁹⁷ It found that President Biden could simply remove the head of the SSA, notwithstanding the existence of a statutory for-cause removal provision.²⁹⁸ It also found the inclusion of the unconstitutional tenure protection provision did not affect the remainder of the statute as Justice Alito did in *Collins*.²⁹⁹

3. Situating *Free Enterprise Fund*

Although predating *Collins* and *Seila Law*, *Free Enterprise Fund* stands as one of the most critical precedents for understanding how the Supreme Court may rule when considering a challenge to the SRO regulatory model.³⁰⁰ The case involved a challenge to a provision of the Sarbanes-Oxley Act, which granted for-cause removal protection to persons appointed to the PCAOB by the SEC.³⁰¹ Despite the absence of

294. *Id.* at 1789.

295. *Id.* at 1799 (Gorsuch, J., concurring).

296. *Id.*

297. Constitutionality of the Commissioner of Social Security's Tenure Protection, 45 Op. O.L.C., slip op. at 1 (July 8, 2021), <https://www.justice.gov/olc/file/1410736/download> [<https://perma.cc/HY3H-ZR9S>] ("The President may remove the Commissioner of Social Security at will notwithstanding the statutory limitation on removal.").

298. *Id.*

299. *Id.* at 15.

300. *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 514 (2010).

301. *Id.* at 486.

any statutory provision explicitly providing for for-cause removal for SEC Commissioners, the Supreme Court has treated the structure as creating a double layer of for-cause removal protections.³⁰² In the majority's view, the double layer of protection rendered the structure unconstitutional on separation of powers grounds because it stripped the President of the power to ensure the faithful execution of law.³⁰³ Professor Nagy predicted this outcome five years before the Supreme Court decided *Free Enterprise Fund* when she explained that "the oversight provided by the formally independent SEC cannot plausibly be expected to function as a presidential surrogate."³⁰⁴

Free Enterprise Fund is notable because the PCAOB sits within a grey area between a government agency and an SRO. In creating the PCAOB, Congress declared that it "shall not be an agency or establishment of the United States Government," and that persons working for the PCAOB shall not "be deemed to be an officer or employee of or agent for the Federal Government by reason of such service."³⁰⁵ These provisions make the PCAOB resemble an SRO. Despite the statute declaring the PCAOB not part of the government, it also provides for PCAOB board members to be appointed by the SEC.³⁰⁶

In his opinion declaring the PCAOB's for-cause removal protections unconstitutional, Chief Justice Roberts distinguished the PCAOB from the NYSE, contending that it differed because the PCAOB "is a Government-created, Government-appointed entity, with expansive powers to govern an entire industry."³⁰⁷ These distinctions may not survive skeptical scrutiny in light of the core rationale behind *Free Enterprise Fund*—the need to protect the President's power to ensure the faithful execution of the laws.

a. Government-Created v. Government-Authorized

As others have recognized, drawing a constitutional line based on whether Congress created a corporation to wield government power or simply authorized a corporation to register and wield government power makes little sense.³⁰⁸ Although SROs generally obtain their entity status through state corporate charters, they derive their power and authority from federal law.³⁰⁹ SROs often enforce federal law, promulgate

302. See Gary Lawson, *Stipulating the Law*, 109 MICH. L. REV. 1191, 1193–94 (2011).

303. *Free Enter. Fund*, 561 U.S. at 496–97.

304. Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and Its Public/Private Status*, 80 NOTRE DAME L. REV. 975, 1056 (2005).

305. 15 U.S.C.A. § 7211(b), *invalidated by Free Enter. Fund*, 561 U.S. 477.

306. *Id.* § 7211(e).

307. *Free Enter. Fund*, 561 U.S. at 485.

308. See McLaughlin, *supra* note 21, at 112.

309. *Id.*

regulations, enjoy power over their industries because federal law mandates membership, and may even be subject to having their rules modified by federal administrative agencies.³¹⁰ In many instances, SROs also enjoy absolute immunity from suit when exercising their regulatory powers.³¹¹

Drawing a constitutional line between whether these entities are government-created entities or government-authorized entities does not relate to the core concern animating *Free Enterprise Fund*.³¹² Whether an entity is chartered under state law or is federally created has no bearing on whether the President is “stripped of the power . . . and his ability to execute the laws—by holding his subordinates accountable for their conduct.”³¹³ The precise method of creation of an SRO does not relate to the underlying separation of powers concerns.³¹⁴

b. Government-Appointed v. Privately Appointed

Chief Justice Roberts also distinguished the PCAOB from the NYSE on the ground that government officials appoint the directors of the PCAOB.³¹⁵ In contrast, the Intercontinental Exchange, the NYSE’s parent company, has its own board of directors elected by its shareholders. Of course, Chief Justice Roberts’s reference to the NYSE could also be taken to refer to FINRA, a nonprofit corporation with a board comprised of industry-elected and board-appointed members.³¹⁶

This distinction may not hold under functionally oriented scrutiny and a direct challenge. The way senior leadership comes to hold a position at an SRO has little relevance to whether the SRO wields government power. Indeed, the way SRO officials take power may create significant Appointments Clause issues.³¹⁷

Of course, the Supreme Court might also continue to see privately appointed leadership as a significant distinction. To the extent that an SRO’s operations remain entirely privately funded with privately appointed leadership, the Supreme Court might treat this fact as cutting

310. See *supra* Section II.A.

311. *Standard Inv. Chartered, Inc. v. Nat’l Ass’n of Sec. Dealers, Inc.*, 637 F.3d 112, 115 (2d Cir. 2011) (“There is no question that an SRO and its officers are entitled to absolute immunity from private damages suits in connection with the discharge of their regulatory responsibilities.”).

312. See *Free Enter. Fund*, 561 U.S. at 496–97.

313. *Id.* at 496.

314. *Id.*

315. *Id.* at 484–85.

316. FINRA emerged in 2007 after the NASD merged with a regulatory arm of the NYSE. Nancy Condon & Herb Perone, *NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority – FINRA*, FINRA MEDIA CTR. (July 30, 2007), [<https://perma.cc/4YHY-53XA>].

317. See *infra* Section II.D (discussing Appointments Clause issues).

against recognizing that the SRO operates as a part of the federal government.

c. Expansive Powers to Govern an Entire Industry

Chief Justice Roberts also distinguished the PCAOB from the NYSE by pointing out that the PCAOB had “expansive powers to govern an entire industry.”³¹⁸ This seemingly differentiates the PCAOB, which regulates the accounting profession, from the NYSE, which regulates its member firms.

This distinction may not hold for many SROs because federal law often requires entire industries to join an SRO.³¹⁹ A person cannot operate a futures firm without joining the NFA. Similarly, any brokerage must join FINRA.³²⁰ When federal law compels membership in an SRO, the SRO achieves the functional power to regulate the entire industry. As SROs also possess the power to make immediately effective rules, they possess expansive power to affect their industries.³²¹

To be sure, federal regulators retain real power and oversight authority over industries regulated by SROs. In most instances, federal regulators will affirmatively approve SRO rules before they take effect.³²² Regulators also retain the power to invalidate SRO rules.³²³ However, just because federal regulators retain power over SROs does not mean that the SROs themselves lack expansive powers over their industries.

Practically speaking, some SROs are substantially larger and more expansive than the PCAOB. Consider the differences between the PCAOB and FINRA. In 2020, the PCAOB had total operating expenses of \$264.9 million.³²⁴ The PCAOB’s inspectors reviewed 219 different audit firms out of a total of 1,726 PCAOB-registered public accounting firms.³²⁵ In contrast, FINRA expended \$1,155.1 million in 2020.³²⁶ FINRA oversees over 600,000 registered brokerage firm representatives

318. *Free Enter. Fund*, 561 U.S. at 485.

319. SEC, GUIDE TO BROKER-DEALER REGISTRATION (Apr. 2008), <https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html> [<https://perma.cc/RZ9C-BWD6>].

320. *Id.*

321. 15 U.S.C. § 78s(b)(3).

322. *See* Hammond, *supra* note 1, at 1736.

323. *Id.*

324. PUB. CO. ACCT. OVERSIGHT BD., 2020 ANNUAL REPORT 28 (Apr. 27, 2021), https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/annual_reports/2020-annual-report.pdf?sfvrsn=581231f1_5 [<https://perma.cc/9FBB-XN5K>].

325. *Id.* at 3, 8.

326. FINRA, 2020 FINRA ANNUAL FINANCIAL REPORT 8, <https://www.finra.org/sites/default/files/2021-06/2020-annual-financial-report.pdf> [<https://perma.cc/88LM-DMAV>].

for over 3,400 member firms.³²⁷ In 2020, it conducted over 1,200 cycle examinations for member firms.³²⁸ FINRA is substantially larger than the PCAOB and rivals the SEC in size.

Although some SROs may be larger than the PCAOB, the Supreme Court has already declared that it sees evaluating the size and scope of a regulatory agency irrelevant for separation of powers purposes. Chief Justice Roberts joined Justice Alito's opinion in *Collins*, which instructed that courts should not "weigh the relative importance of the regulatory and enforcement authority of disparate agencies."³²⁹

Ultimately, the constitutional status of SROs was not before the Court in *Free Enterprise Fund*. Chief Justice Roberts's passing distinction between the PCAOB and an SRO, spanning just thirteen words, will likely be characterized as dicta in a future case, putting the issue squarely before the Supreme Court.

C. State Action Risks

SROs might find much of their power and reach curtailed if the Supreme Court ultimately declares many of their enforcement activities to be state action. Using SROs as frontline regulators changes enforcement because SROs can do things federal regulators cannot when they enforce federal law. An SRO may permanently bar someone from its industry simply for refusing to answer questions that might incriminate them. Federal agencies could not impose such a penalty for simply asserting Fifth Amendment rights.³³⁰ SROs also enjoy the power to enforce seemingly vague rules which would likely be unenforceable by federal agencies.³³¹

Courts applying state action doctrine might substantially limit SROs. Although private entities are generally free to manage their affairs as they see fit, they must respect constitutional rights when their actions are "fairly attributable" to the government.³³² For example, the Supreme Court has found that Amtrak "is an agency or instrumentality of the United States for the purpose of individual rights guaranteed against the Government by the Constitution."³³³

327. *Statistics*, FINRA, <https://www.finra.org/media-center/statistics#key> [<https://perma.cc/TVJ8-CPTR>].

328. *Id.*

329. *Collins v. Yellen*, 141 S. Ct. 1761, 1785 (2021).

330. *See United States v. Solomon*, 509 F.2d 863, 869 (2d Cir. 1975) (finding that an SRO, compelling a member to answer questions in the SRO's investigation, does not violate the Fifth Amendment because the SRO is not a state actor); *see also Jones v. SEC*, 115 F.3d 1173, 1183 (4th Cir. 1997) (same).

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

332. *See Hammond, supra* note 1, at 1729.

333. *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 394 (1995).

In many instances, SRO activities appear fairly attributable to the government.³³⁴ Federal law often requires industry members to join an SRO.³³⁵ Federal law often then compels SROs to enforce federal law.³³⁶ Government agencies often even have the power to amend the SRO's own rules.³³⁷ In this context, an SRO's rules may never truly be entirely its own because it issues its rules with governmental approval and in the shadow of the government's power to demand amendments to its rules. For some matters, SROs even successfully assert sovereign immunity when challenged in court.³³⁸

Scholars and commentators have debated the issue, and some have concluded that SROs should be deemed state actors.³³⁹ Others have urged against increasing federal control over SROs because it would likely turn them into state actors.³⁴⁰ A Supreme Court decision declaring SROs to be state actors would generate substantial problems for SROs and would require them to provide due process in their investigations and to respect the constitutional rights of their members. Such a decision would also substantially impede an SRO's ability to enforce vague rules to capture objectionable conduct.

For the most part, courts have found that SROs are not state actors. Consider one leading case, *Desiderio v. National Association of Securities Dealers, Inc.*³⁴¹ Susan Desidero received a job offer from a bank to work as a securities broker.³⁴² Her employment offer depended on registering with the NASD (now FINRA).³⁴³ Because registering with the NASD required her to sign an arbitration agreement, Desidero

334. See *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982) (explaining when actions may be fairly attributed to the government).

335. 15 U.S.C. § 78o(b)(8).

336. See *Stone & Perino*, *supra* note 98, at 463 (“[T]he compulsion for SROs to perform enforcement activities and the delegation of law enforcement functions to the SROs . . . suggests that SROs should be viewed as state actors when enforcing federal law.”).

337. 15 U.S.C. § 78s(c).

338. See, e.g., *Standard Inv. Chartered, Inc. v. Nat’l Ass’n of Sec. Dealers, Inc.*, 637 F.3d 112, 115 (2d Cir. 2011) (“There is no question that an SRO and its officers are entitled to absolute immunity from private damages suits in connection with the discharge of their regulatory responsibilities.”).

339. Michael, *supra* note 60, at 197 (“Although courts have difficulty with the threshold question of state action in some instances, self-regulatory organizations clearly are so acting.” (footnote omitted)); *Stone & Perino*, *supra* note 98, at 463; Michael Deshmukh, Note, *Is FINRA a State Actor? A Question that Exposes the Flaws of the State Action Doctrine and Suggests a Way to Redeem It*, 67 VAND. L. REV. 1173, 1178–80 (2014).

340. Karmel, *supra* note 12, at 196–97; Birdthistle & Henderson, *supra* note 7, at 54.

341. 191 F.3d 198 (2d Cir. 1999).

342. *Id.* at 200.

343. *Id.*

challenged the requirement because it forced her to waive her constitutional rights to access federal courts and a jury trial.³⁴⁴

The Second Circuit rejected Desidero's constitutional argument because it found that the NASD was not a state actor.³⁴⁵ The court described the NASD, instead, as a private actor not funded by the government.³⁴⁶ It also noted that no statute *required* the creation of the NASD and that the government did not appoint any NASD official.³⁴⁷ It pointed out that the Second Circuit had previously ruled that the NYSE was not a state actor in a case decided in 1975.³⁴⁸

The Second Circuit also rejected an attempt to classify the specific decision requiring securities brokers to agree to arbitration as state action.³⁴⁹ The Second Circuit found that there was no evidence that the SEC required or pressured the NASD to adopt its arbitration policies.³⁵⁰ The SEC's approval of the registration form requiring mandatory arbitration was not sufficient to make the specific requirement to surrender constitutional rights constitute state action.³⁵¹ The analysis did not assign great significance to federal law requiring persons to join the SRO.³⁵²

Whether a supervising federal agency pressures an SRO to take a particular regulatory path may be unknowable. Private individuals often have no means of obtaining communications between SROs and their supervising federal agencies.³⁵³ As SROs are generally deemed private organizations, freedom of information and public records laws do not apply to them.³⁵⁴ At the same time, records of the SEC's supervision of SROs may not be obtainable under freedom of information laws.³⁵⁵

Predicting when courts will declare SRO actions to be state actions remains difficult.³⁵⁶ Older precedents declaring SROs to be private actors may carry less force today after significant amendments to federal law increasing government control over and entanglement with SROs. As these changes have eaten away at the underlying rationales for the early

344. *Id.*

345. *Id.* at 206.

346. *Id.*

347. *Id.*

348. *Id.* (citing *United States v. Solomon*, 509 F.2d 863, 867–71 (2d Cir. 1975)).

349. *Id.* at 207.

350. *Id.*

351. *Id.*

352. *Id.*

353. *See Pub. Invs. Arb. Bar Ass'n v. SEC*, 771 F.3d 1, 2 (D.C. Cir. 2014).

354. *See id.*

355. *See id.* at 7 (“[W]e hold that documents the Commission collects while examining financial institutions—that is, while examining any organization the agency regulates—are exempt from disclosure.”).

356. Hammond, *supra* note 1, at 1729–30.

decisions, lines of decisions finding SROs to be private actors may be vulnerable to reconsideration.

Notably, the Second Circuit rendered its *Desiderio* decision without briefing on the impact of the 1975 amendments to the federal securities laws, which gave the SEC the ability to edit an SRO's rules at its will. The court also did not consider the requirements that SROs enforce federal securities laws. These issues were not raised in *Desiderio*'s opening brief.³⁵⁷ Other federal circuits have reached different conclusions when considering whether and when to classify the SRO's conduct as government action.³⁵⁸

For persons facing SRO enforcement actions where the SRO seeks to enforce federal law, whether and when the SRO qualifies as a state actor carries real significance. If the SRO acts as a private organization, constitutional rights and protections, such as the right to due process and the freedom from self-incrimination do not apply.³⁵⁹ This means that an SRO may bring an enforcement action for a violation of federal law and coerce compliance by threatening to forever bar a person from their profession for any refusal to cooperate. The federal government may then obtain sworn testimony and statements made in that proceeding and use it in criminal prosecutions.³⁶⁰ Some scholars have contended that constitutional protections should apply when SROs enforce federal law because federal law requires SROs to enforce federal law.³⁶¹

Ultimately, the law around when SROs qualify as state actors and when SROs must provide due process remains unsettled and sometimes perplexing. Some decisions have declared that the Constitution requires that SROs must provide due process in certain circumstances.³⁶² Perhaps,

357. See generally Brief of Plaintiff-Appellant, *Desiderio v. Nat'l Ass'n of Sec. Dealers, Inc.*, 191 F.3d 198 (2d Cir. 1999) (No. 98-6100), 1998 WL 34084243 (stating that the underlying issue is whether the imposition by an industry-wide association of a pre-employment agreement requiring the arbitration of all employment disputes, including those involving discriminatory treatment under civil rights laws, is a violation of the affected worker's due process rights).

358. See *Blount v. SEC*, 61 F.3d 938, 941 (D.C. Cir. 1995) (finding that MSRB rules operated "not as a private compact among brokers and dealers but as federal law"); *R.J. O'Brien & Assocs., Inc. v. Pipkin*, 64 F.3d 257, 262 (7th Cir. 1995) (finding that the NFA acts as a government actor when it "requires an applicant to agree to submit to the arbitration rules in order to register").

359. See *United States v. Solomon*, 509 F.2d 863, 872 (2d Cir. 1975) (finding that the NYSE violated a defendant's privilege against self-incrimination by requiring him to answer questions about violations of federal law to remain within the securities industry).

360. See, e.g., *id.*

361. *Stone & Perino*, *supra* note 98, at 492.

362. *Intercontinental Indus., Inc. v. Am. Stock Exch.*, 452 F.2d 935, 941 (5th Cir. 1971) ("The intimate involvement of the Exchange with the Securities and Exchange Commission brings it within the purview of the Fifth Amendment controls over governmental due process."); *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) ("Due process requires that an NASD rule give fair warning of prohibited conduct before a person may be disciplined for that conduct.").

to lessen its *Desiderio* precedent, the Second Circuit has required some due process in the form of an impartial adjudicator on a statutory basis.³⁶³ The Second Circuit also issued an opinion finding an SRO to simultaneously be a “private actor” while granting it absolute immunity as exercising a regulatory power.³⁶⁴

The Supreme Court may eventually address this issue because courts have been divided over when SROs are considered state actors. The issue may also appeal to the Supreme Court because an appeal will present separation of powers, nondelegation, and Appointments Clause issues.

D. *Appointments Clause Risks*

SROs also face grave danger from recent Appointments Clause decisions—one of the major areas of litigation over the constitutionality of the SEC’s adjudicative process. Challenges based on this doctrine may spill over into the SRO context as well.³⁶⁵ The Appointments Clause sets out the methods for appointing “Officers of the United States.”³⁶⁶ It also limits Congress to three different options for the appointment of “inferior Officers” of the United States.³⁶⁷ Those options include appointment by “the President alone,” “the Courts of Law,” or the “Heads of Departments.”³⁶⁸

A threshold question for Appointments Clause cases is whether a particular person serves as an “Officer” of the United States, and if so, what kind.³⁶⁹ In *Buckley v. Valeo*,³⁷⁰ the Supreme Court explained that “any appointee exercising significant authority pursuant to the laws of the United States is an ‘Officer of the United States.’”³⁷¹ Further, in *Morrison v. Olson*,³⁷² the Supreme Court considered four factors to decide whether an independent counsel appointee was a principal Officer or an inferior

363. *D’Alessio v. SEC*, 380 F.3d 112, 121 (2d Cir. 2004) (“[W]e think that provision of ‘a fair procedure’ in SRO disciplinary proceedings gives rise to a due-process-like requirement that the decision-maker be impartial.”).

364. *Santos-Buch v. FINRA, Inc.*, 591 F. App’x 32, 33–34 (2d Cir. 2015).

365. *Cf.* Alexander I. Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. L. 1, 17 (2015) (“A judicial ruling finding [SEC administrative adjudication] unconstitutional because the wrong person signed off on their appointment, or because they are entitled to job protections under the MSPB, would be potentially transformative.”).

366. U.S. CONST. art. II, § 2, cl. 2.

367. *Id.*

368. *Id.*

369. *See Bandimere v. SEC*, 844 F.3d 1168, 1176 (10th Cir. 2016) (“[W]e must consider the creation and duties of SEC ALJs to determine whether they are inferior officers.”).

370. 424 U.S. 1 (1976).

371. *Id.* at 126.

372. 487 U.S. 654 (1988).

Officer.³⁷³ Years later, in *Edmond v. United States*,³⁷⁴ the Supreme Court also found that “the term ‘inferior officer’ connotes a relationship with some higher ranking officer or officers below the President: Whether one is an ‘inferior’ officer depends on whether he has a superior.”³⁷⁵

In *Freytag v. Commissioner of Internal Revenue*,³⁷⁶ the Supreme Court differentiated between whether an official was an “inferior Officer” or a mere employee.³⁷⁷ The Court found that the special trial court judges appointed by the tax court were “inferior Officers” even though they lacked the power to issue final decisions.³⁷⁸ The Supreme Court first noted that these special trial court judges held offices prescribed by law before pointing to their “significant discretion” beyond that of mere employees.³⁷⁹ These powers included taking testimony, conducting trials, ruling on the admissibility of evidence, and enforcing discovery orders.³⁸⁰ After declaring that the Tax Court’s special trial judges were “inferior Officers” for Appointments Clause purposes, the Supreme Court ultimately upheld the appointment structure by finding that the Tax Court was a court of law, although not an Article III court.³⁸¹

The precise test for identifying when a person serves as an “inferior Officer” of the United States remains somewhat unclear. The Supreme Court recently spoke to this issue in *Lucia v. SEC*.³⁸² There, Raymond Lucia marketed a retirement saving strategy he called “Buckets of Money.”³⁸³ The SEC launched an administrative proceeding alleging that Lucia’s marketing and presentations were deceptive.³⁸⁴ The matter was assigned to one of the SEC’s in-house administrative law judges (ALJs) appointed by the SEC’s staff and not by the presidentially appointed commissioners.³⁸⁵ Lucia argued that the ALJ lacked constitutional authority because he was appointed by the SEC’s staff and not the Commission itself.³⁸⁶ Both the SEC and the D.C. Circuit rejected this

373. *Id.* at 671–72. The Court considered whether: (i) another official could remove the counsel; (ii) the scope of the counsel’s duties; (iii) the counsel’s jurisdiction; and (iv) the counsel’s tenure. *Id.* These factors led the Supreme Court to classify the independent counsel as an inferior Officer. *Id.*

374. 520 U.S. 651 (1997).

375. *Id.* at 662.

376. 501 U.S. 868 (1991).

377. *Id.* at 881–82.

378. *Id.*

379. *Id.*

380. *Id.*

381. *Id.* at 891–92.

382. 138 S. Ct. 2044 (2018).

383. *Id.* at 2049.

384. *Id.*

385. *Id.* at 2049–50.

386. *Id.* at 2050.

argument, finding that the ALJ was a mere employee.³⁸⁷ The Supreme Court reversed and applied *Freytag*'s analysis to resolve the issue.³⁸⁸

Two elements drove this analysis. First, the Supreme Court found that the ALJs held a "continuing office established by law."³⁸⁹ This requirement coheres with the Appointments Clause's language stating that it applies to officers "whose Appointments are not herein otherwise provided for, and which shall be established by Law."³⁹⁰ Second, it considered whether the SEC's ALJs wield significant authority.³⁹¹ On balance, the Supreme Court concluded that ALJs possessed as much, if not more, authority than the Tax Court's special trial court judges already found to be "inferior Officers."³⁹² The Supreme Court reversed the D.C. Circuit's decision with instructions that a different, constitutionally appointed ALJ should resolve the case.³⁹³

Precisely how courts will apply these precedents to SROs remains uncertain.³⁹⁴ Still, after *Lucia*, the increasingly conservative Supreme Court has continued to accept Appointments Clause cases. In 2021, a divided Supreme Court resolved *United States v. Arthrex, Inc.*,³⁹⁵ finding that the "unreviewable authority wielded by [administrative patent judges]" is "incompatible with their appointment by the Secretary to an inferior office."³⁹⁶ Chief Justice Roberts wrote the majority opinion, with Justices Alito, Gorsuch, Kavanaugh, and Barrett joining in the first two parts, which found the appointment structure unconstitutional under the Appointments Clause.³⁹⁷

The *Arthrex* opinion included language that may raise the stakes for SROs in future cases. The Court explained that "power acquires its legitimacy and accountability to the public through 'a clear and effective chain of command' down from the President, on whom all the people vote."³⁹⁸ This concern that persons wielding federal power be accountable to the President may cause the Supreme Court to question

387. See Raymond J. Lucia Cos. v. SEC, 832 F.3d 277, 283 (D.C. Cir. 2016), *rev'd and remanded sub nom.* Lucia v. SEC, 138 S. Ct. 2044 (2018), *vacated*, 736 F. App'x 2 (D.C. Cir. 2018).

388. *Lucia*, 138 S. Ct. at 2052.

389. *Id.* at 2053.

390. U.S. CONST. art. II, § 2, cl. 2.

391. *Lucia*, 138 S. Ct. at 2053.

392. *Id.*

393. *Id.*

394. Brodsky, *supra* note 20, at 57 ("[T]here are no bright-line standards for determining whether someone is an officer, rather than an employee, and therefore must be appointed in conformity with the Appointments Clause.").

395. 141 S. Ct. 1970 (2021).

396. *Id.* at 1985.

397. *Id.*

398. *Id.* at 1979 (quoting *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 498 (2010)).

the independence enjoyed by SROs enforcing federal law. In many instances, SROs either appoint their own leadership or their shareholders will elect them.³⁹⁹

A future Appointments Clause challenge to SROs on Appointments Clause grounds would likely revolve around two different issues: when SRO offices are “established by law;” and when SRO officials wield “significant authority.”

1. SRO Offices May Be Established by Law

Thus far, most Appointments Clause challenges have involved adjudicative offices plainly within federal administrative agencies. Tax court judges, the SEC’s ALJs, and administrative patent judges (APJs) all occupy statutorily authorized offices. In contrast, an SRO’s internal administrative structure and offices will not ordinarily be statutorily mandated. This may allow an SRO to argue that its offices are not “established by law” in the sense of the Appointments Clause.

Yet administrative law often governs how an SRO creates an office. SROs seeking to make changes to their rules and organizational structure generally file proposed changes with their supervising agency for approval. For example, the SEC approved the NASD’s decision to reorganize and merge with the NYSE’s member regulation group to create FINRA.⁴⁰⁰

Other laws require that SROs establish offices with particular features. For example, FINRA formed the Office of Hearing Officers (OHO) to comply with a federal securities law requirement that it provide a “fair and impartial procedure” for its discipline and enforcement.⁴⁰¹ Hearing officers admit evidence, rule on motions, render decisions, and impose sanctions.⁴⁰² These offices may be seen as “established by law” either because of a supervising agency’s approval or because of the statutory requirements to create a fair process.

2. SRO Officials Wield Significant Authority

An Appointments Clause challenge would likely consider the degree of authority that any particular SRO wields.⁴⁰³ In many instances, SROs perform the types of actions often performed by government agencies.

399. See Edwards, *supra* note 10, at 614–15.

400. Self-Regulatory Organizations, Exchange Act Release No. 34-56145, 91 SEC Docket 404, 404 (July 26, 2007).

401. *Office of Hearing Officers*, FINRA, <https://www.finra.org/rules-guidance/adjudication-decisions/office-hearing-officers-oho/about> [<https://perma.cc/L4K8-LLK7>].

402. *Id.*

403. See, e.g., *United States v. Arthrex, Inc.*, 141 S. Ct. 1970, 1985 (2021) (holding “the unreviewable authority wielded by APJs during inter partes review is incompatible with their appointment by the Secretary to an inferior office”).

They promulgate rules, conduct investigations, bring enforcement actions, enforce and interpret federal law, decide disputes, and issue sanctions. Given the extensive nature of an SRO's operations, many facets of its operations will involve significant discretionary authority to enforce federal law.

The Supreme Court's resolution of Appointments Clause issues in *Free Enterprise Fund* may also shed some light on how it may approach this issue.⁴⁰⁴ After first ruling that the PCAOB's for-cause removal protection was unconstitutional on separation of powers grounds, Chief Justice Roberts turned to the Appointments Clause issues.⁴⁰⁵ He found that the PCAOB's members were "inferior officers whose appointment Congress may permissibly vest" with the SEC.⁴⁰⁶ The governing boards of SROs occupy functionally similar positions to the members of the PCOAB. Indeed, the PCAOB was largely modeled on preexisting SROs. Thus, the Supreme Court may struggle to differentiate them.

III. MITIGATING THE SYSTEMIC RISK FROM THE SRO MODEL

Collectively, the preceding sections establish that much modern regulation and economic coordination runs through SROs.⁴⁰⁷ They also demonstrate that SROs now face readily foreseeable threats from judicial decisions either substantially limiting their reach or declaring their operations unconstitutional.⁴⁰⁸ A Supreme Court decision invalidating significant SRO activity may have consequences for the U.S. financial system because SROs now play such critical, load-bearing roles.⁴⁰⁹

Merely recognizing that the Supreme Court's direction and doctrines present a systemic risk to the financial system will do little good should the risk materialize. Many may welcome such a decision because it would better align the government with their view of the constitutional framework—even if it triggers a financial crisis. For persons with this view, the "fault" for a crisis would lie not with the Supreme Court for invalidating critical market infrastructure but with Congress for erecting the financial system on an unconstitutional foundation.

Fortunately, foreseeing the risk before it materializes offers an opportunity to plan for how to reduce the likelihood a crisis will occur and blunt its impact if this risk arises. This Part presents structural and litigation management options to reduce risk and options to mitigate the impact of adverse judicial decisions.

404. *See* *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 510 (2010).

405. *Id.* at 508–10.

406. *Id.*

407. *See supra* Part I.

408. *See supra* Part II.

409. *See supra* Section I.E.

A. *Structural Options to Reduce Risk*

A range of different interventions may reduce the risk that the Supreme Court would render a decision sharply limiting SRO jurisdiction and authority. Structural options to reduce this risk steer SROs down two different paths—either granting them greater independence and reducing federal administrative agency control or moving them toward greater integration within the federal chain of command. As a nonstructural risk mitigation technique, SROs and federal agencies might also work to manage litigation risk and reduce the likelihood that a court will consider these issues.

1. Rolling Back Governmentalization

SROs may reduce the likelihood that federal courts will substantially interfere in their operations by gaining greater independence from federal oversight. Many of the risks SROs currently face stem from their federalized role and responsibilities. Congressional legislation and federal administrative agency rulemaking could combine to reduce the degree to which SROs now operate as an arm of the federal government.⁴¹⁰

a. Reduce Federal Law Enforcement Responsibilities

A present, federal requirement that SROs enforce federal law may create risks for SROs on separation of powers, state action, and Appointments Clause grounds.⁴¹¹ Removing these federal law enforcement obligations would reduce the likelihood of federal court intervention in SRO operations. If SROs did not serve as frontline federal law enforcement, the need for the President to have greater control over their operations to ensure the faithful execution of the law would diminish.⁴¹² Similarly, it would become much more difficult to attribute SRO activities to the federal government and declare them to be state actors.⁴¹³ The Appointments Clause risks would also diminish because it would be less likely that courts would characterize SRO officials as principal or “inferior officers” for constitutional purposes.⁴¹⁴

Yet reducing SRO responsibilities to enforce federal law would also likely create significant problems. If SROs ceased their federal law enforcement activities, federal agencies would need to make up for the

410. See Birdthistle & Henderson, *supra* note 7, at 64.

411. See Stone & Perino, *supra* note 98, at 463 (“[T]he compulsion for SROs to perform enforcement activities and the delegation of law enforcement functions to the SROs . . . suggests that SROs should be viewed as state actors when enforcing federal law.”).

412. See *supra* Section II.B.

413. See *supra* Section II.C.

414. See *supra* Section II.D.

shortfall in frontline enforcement. Congress would need to either authorize substantially larger enforcement and oversight budgets or accept substantially reduced enforcement. Even if Congress increased federal enforcement resources, it might impose greater burdens on industry members. Instead of having a single SRO regularly examining their operations, industry members would face examinations and oversight from federal officials and their SRO. On balance, this could reduce efficiency and significantly increase total compliance and oversight costs.

b. Reduce Federal Control Over SRO Operations

Another option to distance SROs from the federal government would be to substantially reduce the degree to which federal agencies control and oversee SRO operations. For financial SROs, this would likely mean removing the SEC's ability to amend or issue SRO rules and its ability to exert control over SRO governance.⁴¹⁵

Reducing federal agency oversight over SROs would reduce the risk that federal courts would declare SROs to be state actors. It would make it more difficult to classify any particular SRO activity as "fairly attributable" to a federal government agency.⁴¹⁶

Still, reducing federal agency oversight over SROs would also create risks. Any reduction in federal SRO oversight likely corresponds with an increased risk that an SRO or its members will frustrate federal policy objectives or maintain artificially high prices for consumers.⁴¹⁷

Too much reduction in federal oversight for SROs could also create real risks for SROs under the private nondelegation doctrine.⁴¹⁸ SROs enjoy delegated federal power under the supervision of a federal administrative agency. If statutory or regulatory changes entirely remove federal agency supervision and leave SROs with federal power, the oversight-free delegation would likely be deemed unconstitutional.⁴¹⁹

2. Increased Governmentalization

Another option to reduce judicial risks for SROs is to pull them deeper into the federal government. By increasing "governmentalization" and accountability of a public authority, SROs reduce the likelihood that federal courts will intervene in their operations.

415. See, e.g., 15 U.S.C.A. § 78s(c) (West).

416. See *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982) (explaining that state action doctrine requires that actions be "fairly attributable" to government).

417. See Judge, *supra* note 184, at 614–18 (discussing ways in which financial intermediaries have influenced regulation to favor rules which give them higher fees).

418. See *supra* Section II.A.2.

419. See *Carter v. Carter Coal Co.*, 298 U.S. 238, 311 (1936) (opining that legislative delegation to a private party is the "most obnoxious form" of delegation).

a. Federal Appointments Without Removal Protections

Shifting the selection process for SRO leadership may substantially reduce risks currently faced by SROs. Consider the Supreme Court's treatment of the PCAOB in *Free Enterprise Fund*.⁴²⁰ There, the Supreme Court struck down removal restrictions, which were meant to protect PCAOB's members, because the restrictions impaired the President's "ability to execute the laws" because the President could not hold "subordinates accountable for their conduct" when executing federal laws.⁴²¹ Placing SRO leaders within the federal chain of command would give the President the power to influence SRO operations.

At present, federal agencies have even less control over SROs than they did over the PCAOB because federal agencies generally do not appoint any SRO leadership. Changes to appointment and removal procedures for SRO board members and significant officers would likely reduce the risk that courts would extend *Free Enterprise Fund* and declare an SRO's operations unconstitutional on separation of powers grounds. This would require substantial changes in SRO governance. Currently, industry members or shareholders often elect much of an SRO's leadership.⁴²² For for-profit SROs, moving to a federal appointment process for SRO leadership would likely require somehow severing profit-focused activities from regulatory authority.

Putting federally appointed officials in charge of SROs would take much of the "self" out of self-regulation. This might increase the risk that the SRO would act in ways that inflate costs for industry members because of a lack of industry-specific expertise. This change would also increase the likelihood that the SRO's activities would be treated as state action.

b. Respect Constitutional Rights

SROs might also reduce the risk of judicial intervention in their affairs by guaranteeing due process and protection from self-incrimination to the targets of their investigations. However, these changes would undoubtedly raise the SRO's enforcement costs without the ability to summarily expel members for declining to answer incriminating questions.⁴²³ This approach implicitly recognizes that SRO activities are "fairly attributable" to the federal government.⁴²⁴

An SRO might attempt to walk a fine line here and only respect constitutional rights when enforcing federal law. SROs might still retain

420. See *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.*, 561 U.S. 477, 496 (2010).

421. *Id.*

422. See Edwards, *supra* note 10, 614–15.

423. See *supra* Section I.C.

424. See *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982).

some flexibility, including the power to summarily expel members when their investigative questions relate solely to the SRO's rules and not to other provisions of federal law. Thus, the SRO might seek to retain its flexibility when acting as a private club while respecting constitutional rights when acting as de facto federal law enforcement. Of course, SROs taking this approach would remain vulnerable to courts that are sympathetic to arguments that federal law compels industry members to join SROs and surrender to their jurisdiction.

c. Fully Nationalize SROs

Another option to reduce risk would be to fully nationalize existing SROs and formally bring them within the federal hierarchy. Making SROs a part of the federal government could be accomplished with a relatively modest budgetary impact on industry members and federal agencies. Congress would need to provide for nationalized SROs to retain their power to set membership fees sufficient to fund their operations. Indeed, Congress has already implemented this type of structure when providing for the FHFA to fund its operations by assessing their fees.⁴²⁵

Fully nationalizing SROs would also likely force a reduction in SRO powers. SROs might struggle to enforce vague rules when operating as a formal part of the federal government. These SROs would also likely incur higher investigation and enforcement costs because their enforcement targets would likely be entitled to constitutional protections.

B. *Active Measures to Mitigate Judicial Risk*

Stakeholders may hesitate to embrace sweeping reforms to either retreat from governmentalization or fully embrace it without judicial decisions forcing the issue. At present, SROs often enjoy the best of both worlds—operating with federal authority and absolute immunity without constitutional restraints. Fortunately, there are options short of immediate structural changes which may mitigate judicial risks to the SRO model.

1. Risk Monitoring

If they are not already, federal administrative agencies and SROs should begin systematically surveilling ongoing cases within the federal court system to thoughtfully monitor cases where courts might issue decisions with significant implications for SROs. Notably, SROs face risk not just from cases where courts consider constitutional challenges to their own operations but also from cases where courts consider constitutional challenges to other SROs. For example, a constitutional challenge to the NFA likely has significant implications for a range of other SROs with similar features. Monitoring ongoing litigation enables

425. See FED. HOUS. FIN. AGENCY, *supra* note 183, at 24.

SROs and federal administrative agencies to launch coordinated responses to cases presenting judicial risk.

2. Generate Favorable Precedents

Awareness of existing constitutional challenges creates an opportunity to attempt to persuade courts to render favorable decisions. When SROs and federal administrative agencies recognize that a pending action may create adverse or favorable precedent, they may devote more resources to the matter. For SROs that are not parties to the action, this may mean that they should hire sophisticated outside counsel to prepare persuasive amicus briefs to inform and influence the court. For SROs that are parties to a case presenting a constitutional challenge, they may allocate additional personnel and resources to the matter to increase the likelihood of a favorable decision. Additionally, they may coordinate with other SROs with interests at stake in the matter to bring in additional support.

Another option may be to attempt to shift cases toward jurisdictions statistically more likely to generate favorable precedents. Systematic forum shopping may increase the likelihood of favorable decisions.

3. Avoid Negative Precedents

SROs may mitigate risk by taking steps to reduce the likelihood of courts creating negative precedents. For example, SROs and federal administrative agencies could simply offer favorable settlement deals whenever a well-resourced litigant raises constitutional challenges to the SRO structure. This could reduce the likelihood that courts would issue negative decisions.

Of course, this type of settlement strategy suffers from a significant weakness. If other litigants observe that SROs and administrative agencies offer unusually generous settlements to litigants raising constitutional challenges, more litigants will raise constitutional challenges. Ultimately, these kinds of active efforts to shape the development of judicial decisions may only slow the rise of adverse precedent.

C. Mitigating Adverse Decisions

The negative impact of an adverse decision may be substantially mitigated with sufficient advance planning and preparation. There are several possibilities for insulating markets from disruption.

1. Contingency Planning

Supervising agencies and SROs should prepare contingency plans for how to respond to a successful constitutional challenge. Putting these

types of plans in place may equip SROs and supervising agencies to mitigate the risk of an adverse decision destabilizing a significant market. Judicial decisions often provide for time before the decision goes into effect. SROs with contingency plans for these situations may be better equipped to swiftly respond and take steps to mitigate damage.

A framework for contingency planning already exists. After the 2008 financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act⁴²⁶ (Dodd-Frank Act) to address systemic risk in the financial system and institute other reforms. The Dodd-Frank Act instructed regulators to require certain systemically important institutions to prepare contingency plans for their “orderly resolution in the event of material financial distress or failure.”⁴²⁷ While these “living wills” should not be viewed as “silver bullets” capable of entirely neutralizing systemic risk, planning for how to respond to a judicial decision invalidating or severely limiting SRO authority would likely improve their response.⁴²⁸

At a minimum, financial regulators should think through and issue guidance on how to respond in advance to an adverse ruling. In contrast, waiting until a decision arrives increases the likelihood of a chaotic response.

2. Contingency Rulemaking & Statutory Authority

SROs and federal administrative agencies may also promulgate rules or seek the enactment of statutes that could be triggered if the need arises. For example, statutes or regulations might provide that in the event of a successful constitutional challenge to the appointment structure for SRO leadership, the supervising agency may appoint the SRO’s governing board and significant officers. These trigger statutes would avoid any gaps in SRO functioning and enable a federal administrative agency to swiftly exercise control over an SRO rendered leaderless by a constitutional challenge.

Waiting to provide for supplemental authority until after the Supreme Court or another federal court reaches a decision risks enormous economic damage to the broader economy. For example, consider the impact of a ruling that a systemically important SRO operated unconstitutionally, rendering its actions legally void. If this type of ruling took a financial market utility offline until Congress acted, a multi-day delay and political uncertainty could immediately disrupt substantial economic activity.

426. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified at 12 U.S.C.A. § 5301).

427. 12 U.S.C.A. § 5365(d)(1).

428. See Nizan Geslevich Packin, *The Case Against the Dodd-Frank Act’s Living Wills: Contingency Planning Following the Financial Crisis*, 9 BERKELEY BUS. L.J. 29, 36 (2012) (explaining the limitations of living wills).

Of course, courts might take contingency rulemaking and statutes as an invitation to declare some SRO activities unconstitutional. Some courts might see preparing for this risk as implicit recognition that SRO activities now exceed constitutional limits. Others might be emboldened to reach such a conclusion by the knowledge that a safety net was constructed to catch financial markets should SROs fall.

On balance, preparing for the risk seems preferable to betting that courts will refuse to issue decisions that would disrupt financial markets. Some Justices may see the attendant disruption as a valuable constitutional lesson. Other Justices may doubt that their decisions could actually destabilize markets. There can be no certainty that refusing to prepare for a foreseeable judicial risk will somehow deter federal judges insulated by life tenure and salary protection.

CONCLUSION

Financial regulators must recognize that the Supreme Court presents systemic risks to the financial system. Systemically important SROs will likely face significant constitutional challenges in the near future. Recent decisions by the majority-conservative Supreme Court have created the precedent and conditions under which future challenges to SRO authority will arise. Because an adverse decision could destabilize markets, regulators and policymakers must carefully consider whether and how to insulate markets from judicial risk.

Thus far, the SRO model has proved remarkably effective at insulating markets from politically driven instability. During government shutdowns and interruptions, financial markets continue operating largely unimpeded because modern SROs detach market functioning from Congressional and budgetary politics. Yet, despite SROs largely avoiding political risk, significant judicial risk to their operations and markets remains.

Congress, federal regulators, and SROs should prepare for the entirely foreseeable risk that courts will soon significantly interfere in the SRO model. Adequate preparation may reduce the likelihood of these risks materializing through some form of prudential restructuring. In the alternative, federal regulators must prepare to assume significant SRO responsibilities should a court declare some significant facets of the SRO model unconstitutional.