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Corporate Board Diversity Mandates in the United States

A Legal Lens on *AFBR v. SEC*

OTMU1114 Rights-Thinking: Exploratory Workshop on Current Legal Issues in the U.S.A.

Bachelor's thesis

Author:
Waltteri Lindqvist

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Abstract page

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This bachelor's thesis examines how the U.S. Constitution affect guidelines issued by private companies, especially when said guidelines potentially violate an individual's fundamental rights. In the case *Alliance for Fair Board Recruitment (AFBR) v. Securities and Exchange Commission (SEC)* the question was whether national stock exchange may set rules on how listed companies must compose their board.

The rule insists that all the listed company boards must have quotas for women and for other minorities who usually have not been presented in bigger companies' boardrooms. AFBR stated for example that this rule violates the Fifth and the First Amendment to the U.S. Constitution. The Fifth Circuit Court of Appeals ruled that a company registered as private may issue rules that could be seen unconstitutional. According to the court's ruling, a private operator cannot impede an individual's rights, since only an authority could do that.

There has also been conducted numerous research about diverse boards' positive effects on companies' e.g. financial situation and governance to back up the arguments for board diversity rules. The question on the table is interesting, as there are previous cases where a similar rule has been banned, however, as it has been given at the level of the law. Considering the latest Supreme Court cases and overruling, *AFBR v. SEC* may also potentially take an interesting turn if it is decided to continue the controversy in the Supreme Court.

Key words: board diversity, Constitution, corporate governance, directors, public companies, drittwirkung, state action, entwinement test

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List of Abbreviations

NASDAQ	National Association of Securities Dealers Automated Quotations Stock Market LLC
SEC	United States Securities and Exchange Commission
OECD	Organization for Economic Co-operation and Development
AFBR	Alliance for Fair Board Recruitment
NCPPR	National Center for Public Policy Research
SFFA	Students for Fair Admissions
SEA	Securities Exchange Act
LLC	Limited Liability Company
CBS	Columbia Broadcasting System, Inc.
DNC	Democratic National Committee
NAACP	National Association for the Advancement of Colored People
TSSAA	Tennessee Secondary School Athletic Association
SRO	Self-Regulated Organization
NRPC	National Railroad Passenger Corp.
DT	Department of Transportation
AAR	Association of American Railroads

1 Introduction

The responsibilities of the board of directors has been on the corporate agenda for years. Acting as the agents of the shareholders, directors are expected to collectively devise operational and financial strategies for the organization and to monitor the effectiveness of the companies' practises. The board of directors constitutes a fundamental element within a resilient corporate governance structure. This is evidenced by the OECD Principles of Corporate Governance, stating that: "The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the accountability of the board to the company and the shareholders". This statement links to the fundamental concept of corporate governance, namely judgment, responsibility and accountability.[1] Studies, e.g. "Women Create a Sustainable Future", have found that companies with more women on their boards are more likely to "create a sustainable future" by, among other things, instituting strong governance structures with high levels of transparency.[2] Studies have also found that female corporate leaders are less likely to engage in corporate fraud,[3] which in my opinion, needs to be taken very strongly into account. Criminal law perspective weighs even more than soft law governance in business.

In early December 2020, the United States based corporation Nasdaq Stock Market LLC (Nasdaq)[4] filed with the United States Securities and Exchange Commission (SEC) a proposal for new listing rules regarding board diversity and disclosure. On August 6, 2021, the SEC approved the Nasdaq proposal that would establish a disclosure-based framework to advance board diversity and enhance transparency in board diversity statistics. The SEC's new Release No. 34-92590[5] sets out a recommended objective that companies listed on Nasdaq's US exchange must have two diverse directors, including one self-identified woman director, one director who identifies as underrepresented minority or as LGBTQ+. If the company does not satisfy both criteria, they must explain the reason why they don't have two diverse directors.

Following the decision, the Alliance for Fair Board Recruitment (AFBR) sued the SEC over the board diversity rule in the Fifth Circuit Court of Appeals.[6] AFBR and other petitioners,

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[1] OECD Principles of Corporate Governance 2023 (principle V).
[2] McElhaney – Mobasseri 2012, p. 4. See also Spierings 2023, p. 7.
[3] Maulidi, Ach 2022, p. 323-324.
[4] Distinguish here: Nasdaq Stock Market (which is an American stock exchange fully owned by Nasdaq Stock Market LLC).
[5] SEC Release No. 34-92590; File Nos. SR-NASDAQ-2020-081; SR-NASDAQ-2020-082.
[6] Brief of petitioner Alliance for Fair Board Recruitment in *AFBR v. SEC.*

such as National Center for Public Policy Research (NCPPR) argued that SEC lacks — or exceeded — authority in approving the rule. They also argued that the rule violates the First and Fifth Amendment to the United States Constitution's free speech and equal-protection principles as well as the Securities Exchange Act and the Administrative Procedure Act. Briefly, the court ruled that the Nasdaq's rule and the SEC's Approval Order do not violate the aforementioned rules.[7]

In this thesis, I am interested in the way Nasdaq occupies itself in the U.S. market. While the authorities must see to it that their activities are in accordance with the Constitution, stock exchanges are not considered public entities. Even though they seem like one due to the surveillance of the SEC, they still are treated as a private stock market provider. Since the Nasdaq does not meet the characteristics of state action, it cannot infringe the petitioners' constitutional rights. But what does state action actually mean? This is a question I will try to clarify in this thesis as well. There is a more general problem of the construction of rights by common law if Nasdaq's operation would be considered state action. This problem would then also seem to be at the heart of *Students for Fair Admissions v. Harvard* and *303 Creative LLC v. Elenis* when examining the racial quotas.[8]

I will first, in section 2, provide a glance at my research materials and explain the way I have conducted my analysis. After that, I will present the results of my analysis through the following elements: I will first discuss briefs of the petitioners and their demands in section 3. Then, I will move on to discuss the briefs of the respondents and the court opinion in section 4. In the sections 5, 6 and 7 I will delve deeper in the state action doctrine and how it is defined in Supreme Court cases. I will go through some of the state action tests the Supreme Court has produced to be used in lower courts. Finally, I will discuss the composition of the 5th Circuit Court of Appeals to analyse the political aspects of the U.S. courts in section 8. In the concluding section 9, I will reflect on what was said in the previous sections and present the most important results of my analysis. I will also ask where all of this leaves us: What could be the next problem of studying and what could be the outcome if *AFBR v. SEC* proceeds to U.S. Supreme Court?

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[7] *AFBR v. SEC*, p. 6.
[8] *SFFA v. Harvard*. See also *303 Creative LLC v. Elenis*.

2 Research materials and methods

For this thesis, I will be using primarily case argumentation analysis enhanced with some case analytics to interpret the meaning of what is a state actor and how e.g. U.S. Constitution affects institutions bound by it. As Justice Kavanaugh states in *Manhattan Cmty. Access Corp v. Halleck*, "[the U.S. Supreme] Court's state action doctrine distinguishes the government from individuals and private entities".[9] This approach argues that the Constitution should only apply to decisions and orders made by U.S. officials, as a private operator cannot violate another individual's fundamental rights. To clarify this significance, I will place the aforementioned amendments in previous U.S. Supreme Court and appellate court rulings by utilizing case genetics.

The main materials that are used in this thesis are the case materials from *Alliance for Fair Board Recruitment v. SEC*. I will try to go through the opinion of the court carefully, which will show the judges' views as reasons for their final decision. I will also use both the briefs of petitioners and the respondents, which shows the arguments that both sides tried to use to win their case. It is interesting to notice that both parties use the same old cases as an example and have nevertheless applied them in different ways. Thus, I would like to note that I am going to use not only case argumentation analysis in the text, but also case genetics to get a broader outlook of the scope of the constitution and the diversity of corporate boards. Having understood that *AFBR v. SEC* (2023) is naturally the most important case for the purpose of this paper, I also found in the petitioners' brief that the same theme has already been handled in e.g. *Meland v. SEC*.

As I went through these briefs, court ruling and previous cases, I also found several studies related to corporate governance and more specifically the diversity of corporate boards. I will address them in the text, as they give a fairly important background to why this topic is important in the first place and why it is being debated in the courts. It is important to clarify that this paper does not seek to participate in the political aspects of corporate board diversity, and thus does not serve as a critique of the pursuit of diversity. Instead, this paper seeks to use the tools we have gained from parties arguing about these issues in courts and academic forums to analyse U.S. common law system in general.

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[9] *Manhattan Community Access Corp. v. Halleck*, p. 5.

3 Brief of the petitioners

The petitioner Alliance for Fair Board Recruitment is a non-profit membership corporation and has no parent corporations or subsidiaries.[10] According to its webpage, their mission is to "promote the recruitment of corporate board members without regard to race, ethnicity, sex and sexual identity".[11] The statements of the issues of AFBR were that firstly, the SEC's order and the rule of Nasdaq violate the Fifth Amendment's equal-protection clause. It should be noted, however, that the equal-protection clause is further considered in the 14th Amendment, although the petitioners claim it is in the 5th Amendment. The Court also cites the Petitioners as appealing to the 14th Amendment. Secondly, AFBR claims that the rules also violate the First Amendment's free-speech principles. Lastly AFBR argues that the SEC had no authority to bring such rules into force.

For the background, the Fourteenth Amendment to the United States Constitution states that "All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."[12] Broadly, therefore, it could be seen that such minority quotas imposed by the Nasdaq would be unconstitutional, as they would place e.g. men in an unequal position comparing to women, members of the LGBTQ+ and other minorities stated in the Nasdaq rule. To give a better view about this problem, in the case *Meland v. Weber* the court ruled that a similar board diversity rule in California was unconstitutional because the "[Senate Bill] requires company's shareholders to discriminate on the basis of sex when exercising their voting rights, in violation of the Fourteenth Amendment".[13] This Bill required every California headquartered companies have a quota for females on their board of directors.

However, the Amendment holds this rule only for laws passed by the State. In other words, the Constitution only applies to state action. This was also stated in the U.S. Supreme Court case: *Manhattan Cmty. Access Corp v. Halleck.*[14] The question here is whether Nasdaq can be

[10] Brief of petitioner Alliance for Fair Board Recruitment in *AFBR v. SEC*, p. 1.
[11] Alliance for Fair Board Recruitment 3.3.2024.
[12] U.S. Const. Amend. XIV.
[13] *Meland v. Weber*, p. 4.
[14] *Manhattan Community Access Corp. v. Halleck*, p. 9.

seen as a public institution. If we think through, the SEC is at least such an institution, and it confirmed the Nasdaq rule.

The main state-action theories from the petitioners were that Nasdaq itself is a public entity and that Nasdaq's rules could be seen as governmental rules. The reason why petitioners see Nasdaq as a state entity is that Nasdaq is, in their words a "[C]reature of federal law, serves federal interests, and is controlled by federal agency".[15] The theory is mostly based on the relationship between the Nasdaq and the SEC. This brings us to a interesting dilemma that if Nasdaq is allowed to make rules on its own, what role does the SEC play as the constitutional guardian in this regard.

Nasdaq is a private limited liability company (LLC) owned fully by another corporation, Nasdaq, Inc.[16] So in practice, then, Nasdaq is like any other U.S. company that aims to make a profit for its owners. However, Nasdaq differs from a conventional limited liability company in that its operations are controlled by the SEC. Nasdaq provides a variety of financial services that are heavily regulated in the U.S. and therefore Nasdaq is required to report its activities to the authorities.

The SEC, in turn, is a government authority that e.g. oversees financial markets and enforces the rules of the exchanges. Its main goals are to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC was created in 1934 after the stock market crash in 1929 and its operation is based on the Securities Act and Securities Exchange Act (SEA). The main purposes of these laws are reduced to two common-sense notions: "Companies offering securities for sale to the public must tell the truth about their business, the securities they are selling, and the risks involved in investing in those securities."[17]; and "Those who sell and trade securities – brokers, dealers, and exchanges – must treat investors fairly and honestly." [18] It should also be noted that the SEC's actions must comply with the Administrative Procedure Act (APA).[19]

The SEA states that the exchange must have rules among other things "to promote just and equitable principles of trade… to remove impediments to and perfect the mechanism of a free

[15] *AFBR v. SEC*, p. 8.
[16] *AFBR v. SEC*, p. 8
[17] Securities Act of 1933.
[18] Securities Exchange Act of 1934.
[19] Administrative Procedure Act of 1946.

and open market and a national market system, and, in general, to protect investors and the public interest." The most interesting thing of this part of the law is that the SEA actually requires the stock exchange to produce its rules to promote the market system and make sure the markets are equal to everyone.[20] This principle clashes, at least in the opinion of the petitioners, with the idea that now a national stock exchange can influence corporate self-decision-making and the free market, while at the same time putting certain groups of people ahead of others.

Creighton R. Meland also agrees with this relationship between free market and regulation. Meland argues that if diversity really improved performance, qualified leaders would strive for and achieve diversity without a government order. In the *AFBR v. SEC,* Meland equates "government" with the SEC's approval. Meland also states that if diversity does not improve performance, forcing companies to achieve diversity will either harm them or not do good. He believes that the market would see itself if board diversity actually helped companies to perform better. In this environment, no statutory requirement is necessary or conducive to the state interest.[21]

This leaves us wondering what the purpose of the SEC and Nasdaq's rules is and how the court will justify this decision when, clearly according to the SEA, Nasdaq's rule and the SEC's approval do not fully comply with the principles of free market and equity. In theory, therefore, the rule has nothing to do with the Constitution (as in the case of *Meland v. Weber*), when we have already established that Nasdaq is not a state actor. But how have the defendants justified their decision and how has the court reached a decision granting it?

[20] Securities Exchange Act of 1934, 15 U.S.C. § 78e.
[21] Meland 2019, p. 22.

4 Respondents' arguments and court decision overview

Although the petitioners had several claims and various arguments to overturn the Nasdaq rule, the court decided to uphold the judgment and deny all petitioners' claims. The court was unanimous, judges Stewart and Dennis joining the judge Higginson's written majority opinion.[22] The SEC's arguments would seem to be built on the idea that there is a contractual freedom-based relationship between Nasdaq and the companies listed in its stock market.[23] In this case, the constitutional rights or the SEC jurisdiction would not really matter as much, as the freedom of contract has been considered a fairly important doctrine in the common law countries, such as the United States.[24] Does that not also mean that the company has accepted the terms when it is listed on the national stock exchange? The court very quickly concluded that the Constitution is not an impediment to Nasdaq's activities in this matter, so as a rule, I will focus on lower-level regulations (such as SEA) that the SEC must comply with.

Within this idea of contractual freedom, the SEC has three main supporting justifications why government diversity regulations are profitable for society. The first justification for the diversity rule is that investors must have access to information about the diversity of the company in order to make proper investing decisions. In their brief, the SEC mentions that many institutional investors have asked companies to disclose their diversity to the public. Major investors, such as Vanguard and BlackRock have even made guidelines for their investing decision-making regarding company diversity.[25]

This argument may well be derived from the SEC's second argument, which was mentioned in the introduction. This argument therefore relates to the evidential benefit in situations where the board or directors of a company is as diverse as possible. Among other research presented in this thesis, also an Australian study found that "a mix of skills, knowledge and experience on boards is necessary for independent, well-informed decision-making which is in the best interest of the company and its shareholders".[26] So, in addition to providing investors with up-to-date information on the company's board composition, according to the Nasdaq, there is so much evidence of board diversity that adopting such rule would have a largely positive impact on companies listed on the Nasdaq. Nevertheless, is this really a

[22] *AFBR v. SEC.*
[23] Brief of Respondent Securities and Exchange Commission in *AFBR v. SEC*, p. 8.
[24] Chrenkoff 1996, p. 44.
[25] Brief of Respondent Securities and Exchange Commission in *AFBR v. SEC*, p. 13.
[26] Adams 2015, p. 131.

reason the SEC should recognize? Above, we talked about the fact that markets tend to be efficient and if diversity helps companies in financial matters, the market itself should fix this. As we speek, the SEC actually did not rest its approval on these findings about improved company performance.[27] This was mainly Nasdaq's argument.[28] It was seen in the court as "substantial evidence". The court also stated that even though the SEC didn't rest its approval on evidence of improved performance thanks to diversity, it does not limit the SEC to consider the fact as pro-speaking fact.

The Court corrected the Petitioners' argument in this regard. The decision stated that the company is not entirely obliged to appoint at least two diverse members, as they can also give an explanation of why diverse members do not exist instead.[29] Or, they can just pick another stock exchange, as the SEC stated. In the Approval Order the SEC explained that "while there would be costs to listing elsewhere, companies that object to providing any explanation can choose instead to list on a different exchange. No company is required to list on Nasdaq".[30] This seems to be also one of the main reasons the court was on the SEC's side in this case. It would be a very different starting point if Nasdaq was the only stock exchange in the U.S, meaning that Nasdaq would have a monopoly, and they could produce any rules under this guise. In this current situation, Nasdaq sees itself in a situation where they must compete for their clients through listing costs among other things.

Finally, as a third justification, the SEC argued that Nasdaq's rule has been approved and it is consistent with the requirements of the SEA. The main thing, once again, was that board diversity rules are not mandating any specific board composition but rather focuses on the publicity of the composition and election of the board.[31] The Court considered the SEA as a fairly broad act, considering the limits of jurisdiction, and thus ruled that the petitioners had provided no evidence that the SEC's approval order was not in line with the SEA.[32]

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[27] Brief of Respondent Securities and Exchange Commission in *AFBR v. SEC,* p. 16-17.
[28] Brief of Intervenor the Nasdaq Stock Market LLC in *AFBR v. SEC,* p. 13.
[29] *AFBR v. SEC*, p. 33.
[30] *AFBR v. SEC*, p. 6.
[31] Brief of Respondent Securities and Exchange Commission in AFBR *v. SEC,* p. 15-16.
[32] *AFBR v. SEC*, p. 39.

5 Horizontal or vertical effect of constitutional rights?

Now that we have determined that the rules of the Nasdaq are justified by the 5th Court of Appeals and do not violate the fundamental rights of AFBR or other companies listed on the Nasdaq Stock Exchange, it is worth looking at the scope of the Constitution from a slightly deeper perspective. As an eternal question, the scope of application has been a controversial topic in comparative constitutional law for a long time. How and to whom the Constitution is applied is seen as either a horizontal or a vertical effect, which means that "[t]hese alternatives refer to whether constitutional rights regulate only the conduct of governmental actors in their dealings with private individuals (vertical) or also relations between private individuals (horizontal)".[33] It is evident that U.S. relies more on the vertical effect, as can be seen, for example, in the case *AFBR v. SEC.*[34] The doctrine that follows from vertical constitutional effect is called the "state action doctrine", which has been discussed also in many other cases along with *AFBR v. SEC.*[35]

When considering state action doctrine in a simple way, one could quickly conclude that such doctrine could be quite dangerous for individuals. After all, constitutional rights often have a strong connection to fundamental human rights. If we compare this U.S. doctrine with European law, the horizontal effect (Drittwirkung) seems to be more clearly in use in European jurisprudence.[36] For example, discrimination on the basis of a personal characteristic is quite unambiguously prohibited in Finland (as stated in the Finnish Constitution 6 § and Non-discrimination Act 8 §) and thus it directly obligates the private party as well. In principle, there is no such direct obligation on the basis of the state action doctrine as U.S. recognise fairly strict vertical approach to this issue. However, it is not at all so simple as there can be found some inconsistencies in the U.S. Constitution also.[37] For example, the Thirteenth Amendment unequivocally prohibits private individuals to engage in slavery or involuntary servitude.[38]

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[33] Gardbaum 2003, p. 388.
[34] *AFBR v. SEC, p. 7.*
[35] *CBS v. DNC. See also Jackson v. Metro. Edison Co.; Flagg Bros v. Brooks; Rendell-Baker v. Kohn; Lugar v. Edmondson Oil Co.; Blum v. Yaretsky*.
[36] Engle 2009, p. 165 (horizontal direct effect and *unmittelbare Drittwirkung* are synonyms).
[37] Gardbaum 2003, p. 394.
[38] U.S. Const. Amend. XIII.

6 State action doctrine in case law

Once we have understood the horizontal effects of fundamental rights - or rather their non-existence in the US fundamental constitutional field – it is worth going back to the 14th Amendment, which is the most essential Amendment to this case and to those involved in it. However, with regard to this Amendment, the Supreme Court has declared that this Amendment shall be applied only to state actors, as already mentioned in the third chapter of this thesis.[39] In this section I will take a closer look at the state action doctrine and its purposes in the U.S. constitutional playground. As Ayoub (1984) suggests, the "[s]tatutory construction of the limitations of the fourteenth amendment began with the *Civil Rights Cases* in 1883 when the Civil Rights Act of 1875, which prohibited racial discrimination in public accommodations, was declared void". It sounds relatively rough, but this seems to be the state action doctrine's basic idea. Later cases e.g. or *Jonas v. Alfred H. Mayer Co.* in 1968 (which basically overruled the *Civil Rights Cases)* or *Shelley v. Kraemer* in 1948 reshaped the view of discrimination between private parties.[40]

If we pay more attention to those cases, in *Shelley v. Kraemer*, Shelley family bought a house in St. Louis, not knowing that "Negroes or Mongolians" would not be allowed to buy the house due to the racially restrictive covenants in the neighbourhood. Their neighbour then appealed to the Missouri Supreme Court, after which the case was also heard by the U.S. Supreme Court. The respondents of the case wanted to overturn the Shelley family's control of this acquired property. [41] At the same time, there was another similar case, *Sipes v. McGhee*, which was consolidated with *Shelley v. Kraemer* by NAACP to be tried at the U.S. Supreme Court.[42] The unanimous decision by the Supreme Court was a significant landmark case that held that racially restrictive housing covenants are illegal, only if they are not agreed mutually. The Court held that "the restrictive agreements standing alone cannot be regarded as violative of any rights guaranteed to petitioners by the Fourteenth Amendment. So long as the purposes of those agreements are effectuated by voluntary adherence to their terms, it

[39] Ayoub 1984, p. 893 (Ayoub suggests, that the first Supreme Court case to make this distinction was the Civil Rights Cases, 109 U.S. 3 (1883)).
[40] *Jones v. Alfred H. Mayer Co.,* p. 443*. See also Shelley v. Kraemer.*
[41] *Shelley v. Kraemer,* p. 4-6
[42] *Shelley v. Kraemer,* p. 1 footnote.

would appear clear that there has been no action by the State and the provisions of the Amendment have not been violated".[43]

This ruling was interesting, at least in a somewhat complicated way. The court ruled that racially restricted covenants are, in principle, legal, as long as both parties voluntarily agree to abide by them. And if the other party then considers that these covenants have not been complied with, they would not be able to argue with them in court, as then the state action would become part of the game and thus such a racially restricted covenant would be illegal under the 14th Amendment. So, on a practical level, this case was a great victory for oppressed groups of people, but in the larger picture, this could also have great value in *AFBR v. SEC*. Why is that? If you compare the situation with the fact that AFBR and Nasdaq are considered private individuals, then the agreement they have entered in, with a rule indicating discrimination, will only be valid if they have mutually agreed to do so. In *AFBR v. SEC,* however, Nasdaq sought this justification from a state actor, i.e. the SEC, and eventually obtained it from another state actor, the 5th Court of Appeals.

To understand more about the state action theme in *AFBR v. SEC,* it is convenient to look at another case in which state action has also been dealt with. In *Brentwood Academy (Brentwood) v. Tennessee Secondary School Athletic Association (TSSAA),* an interscholastic sport-association was considered a state actor for First Amendment and Due Process (14th Amendment) purposes. For the background, Brentwood received a $3000 fine and ban from state playoff games for allegedly arranging illegal practices for eight grade boys to recruit public school athletes to private school. The petitioners argued that TSSAA was involved in state action when fining Brentwood. The court decided, in 5-4 vote that "the [Tennessee Secondary School Athletic] association's regulatory activity may and should be treated as state action owing to the pervasive entwinement of state school officials in the structure of the association, there being no offsetting reason to see the association's acts in any other way".[44]

Justice David Souter delivered the opinion of the court. The reason court found that TSSAA is a state actor was that "[t]he association in question here includes most public schools located within the State, acts through their representatives, draws its officers from them, is largely funded by their dues and income received in their stead, and has historically been seen to

[43] *Shelley v. Kraemer*, p. 13.
[44] *Brentwood v. TSSAA*, p. 291.

regulate in lieu of the State Board of Education's exercise of its own authority".[45] Thus, although TSSAA is legally a private association, its history and other state actor entities affecting it influence its activities to the extent that it can be indirectly considered a state actor. I bring *Brentwood v. TSSAA* to this because a similar theme was also discussed in the *AFBR v. SEC.* However, it was decided very strongly that Nasdaq would not be affected by the SEC, even though it oversees its operations and enforces the rules it came up with for the operations of the stock exchange.[46]

A somewhat similar case related to this is *Rendell-Baker v. Kohn* in 1982. In this case, petitioner Rendell-Baker brings an action because he was dismissed from the role of school counselor in retaliation for his opinion on the school's administrative policy. The school in the case was private and the Supreme Court ruled that the dismissal was legal and did not violate the constitutional rights of the petitioner, although the school's rules come from the state and the school is also funded by the state.[47] In this case, Justice Marshall filed a dissenting opinion, in which Justice Brennan joined.[48] This similar issue took an interesting turn, as, as in Justice Marshall's dissenting opinion, the Justices of the majority opinion in *SFFA v. Harvard* also concluded that if the school is regulated in some way by the government, it must have a state action link and therefore must comply with constitutional rights.[49] Although the application of state action doctrine was not the most important argument in the *Harvard* case, it played a really important role and is important for the development of state action doctrine in the United States.

Although the state action doctrine restricts the application of constitutional protection directly between private entities, it is worth noting that efforts have been made over the years to patch up such constitutional protection absence, for example with the Civil Rights Act of 1964 (CRA) and the Americans with Disabilities Act. In *Bostock v. Clayton County*, the Court held that CRA protects employees against discrimination because of sexuality or gender identity.[50] In this particular case, no state action theory was discussed.

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[45] *Brentwood v. TSSAA,* p. 290-291.
[46] *AFBR v. SEC,* p. 17-20.
[47] *Rendell-Baker v. Kohn*, p. 830.
[48] *Rendell-Baker v. Kohn*, p. 844..
[49] *SFFA v. Harvard*, p. 291.
[50] *Bostock v. Clayton County*, p. 33.

7 Policies behind the state action doctrine

Since *Brentwood*, there has been a general discussion that the court has developed a kind of entwinement test from this case, by which the court determines the fulfilment of the state action. But other tests have also been promoted by the United States Supreme Court. Opinions on these tests and state action doctrine in general are, however, highly volatile.[51] "The right to be free from racial discrimination is such an important right that the Supreme Court will go to almost any length to protect it, even if it means manipulating the law to obtain a desired result."[52] These are the words by which Robin Petronella begins his commentary on the Supreme Court's approach to state action doctrine in the Brentwood case. A tough opinion, but it seems to be that with this comment Petronella wants to bring out her point of view, which is that the Supreme Court tends to stretch the boundaries of governmental action whenever it comes to racial discrimination. She feels that the state action doctrine should be scrapped at some level, as the Supreme Court does not remain consistent with the doctrine and this creates uncertainty for, for example, all companies with even the slightest connection to government bodies.

The Supreme Court has formed numerous tests for the lower courts, but I will here address only a few of the relevant ones.[53] I will focus more closely on State Compulsion Test, Joint Action Test and Entwinement Test, since these tests seem to be most relevant to the case I'm reviewing, *AFBR v. SEC.*

Firstly, I will discuss the State Compulsion test. As David Howard explains, "When courts use the state compulsion test, state action is found "when the State has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State."" But simply following a regulatory scheme generally does not make a private party a state actor, and like the nexus test, state regulation of an entity alone is not sufficient to show state action under the state compulsion test".[54] In short, this "Nexus Test" means that the private operator and the state are so close together that the action can just as well be considered a state action.[55] The test is therefore very close to the State Compulsion Test. Howard mentions *Estedes-Negroni v. CPC Hospital San Juan*

[51] Turner 2013, p. 281.
[52] Petronella 2002, p. 1057.
[53] Brown 2008, p. 565-567.
[54] Howard 2017, p. 232.
[55] Brown 2008, p. 566.

Capestrano in which state action was not found because "Estedes failed to allege facts that would support a finding that the state coerced or encouraged Appellees to pursue or otherwise participate in her involuntary commitment".[56]

The Entwinement Test, also sometimes called Symbiotic Relationship Test, means that the court "examines the relationship between the state and the private entity to determine if the government is entwined with the private group's management or control".[57] This test also has close relation to the Nexus Test. Howard represented a relevant case also in this regard to use as an example in which the Entwinement Test was discussed. The case was *Grogan v. Blooming Grove Volunteer Ambulance Corps. (BGVAC)*, a United States District Court case in New York in 2013, where the plaintiff claimed that her constitutional due process rights were violated. She was suspended as an officer of BGVAC, and she didn't get the chance to have a hearing before suspension. In practice, BGVAC carried out a public task on behalf of the town in the performance of medical services for the residents of the city. The activity, of course, is a regulated practice of the profession. BGVAC's actions were not seen as state actions, because "like the state compulsion test, statutes and regulations alone are not enough to make a private party into a state actor". [58]

Finally, I would like to discuss the Joint Participation test. According to it, state action is based on "actual interaction between the state and the private party and not just interrelatedness between the two". This test is about the fact that the state has a certain agenda that they want to go through and to get this done the state encourages the private entity so much that the decision of the private operator to choose to make that decision can be seen as a state action or "cloaked with the authority of the state". [59]

As I mentioned above, these tests are very relevant to *AFBR V. SEC*. Why is this? If the Supreme Court makes such tests available to lower courts, the case-law should become consistent throughout a nation of the size of the United States, thus increasing legal certainty between states. But can this really be seen as the case? These tests were not directly mentioned in *AFBR v. SEC* other than the joint participation test, which was also briefly discussed.[60] However, it was not the case that the court did not assess the implementation of

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[56] *Estades-Negroni v. CPC Hospital San Juan Capestrano*. p. 5.
[57] Brown 2008, p. 567.
[58] Howard 2017, p. 233. See also *Grogan v. BGVAC*, p. 13-16.
[59] Brown 2007, p. 567.
[60] *AFBR v. SEC*, p. 19.

the state action in that case. On the contrary, state action was actually the topic that was dealt with the most. And that's natural, because the court did recognise that in order to the rules being unconstitutional, there must be state action involved. I will now explain how the Court dealt with the tests in this case. They give a good idea that the use of tests can also be applied independently of the court.

The petitioners' state action justifications in *AFBR v. SEC* were that "Nasdaq itself "is a state actor constrained to act within constitutional bounds because it is a creature of federal law, serves federal interests, and is controlled by a federal agency"".[61] If we dismantle this argument to talk about state action tests, the "creature of federal law" could be understood in a way that the SEC wanted to establish the Nasdaq in order to use the power that is limited by the constitution. But as the court stated, this was not the case, since Nasdaq is not established by state, if compared to entities presented in cases *Lebron v. National Railroad Passenger Corp.* (NRPC) and *Department of Transportation* (DT) *v. Association of American Railroads.* (AAR).[62] Nasdaq is spoken more as a self-regulated organization (SRO), although it is regulated at the state level. Its core activities are therefore not directly affected by state action.

The "serves federal interests" argument was brought down mostly by arguments that Nasdaq created these proposed rules by its own and the SEC later accepted them.[63] This implies that the SEC has therefore not influenced in the making of these rules in any way and therefore there is no "government interest" in the rules. Nasdaq rather protects investors with this and does not pursue other interests.

Finally, the "controlled by federal agency" argument was discussed a little broader than the aforementioned arguments. The court answered to this mostly relying on *Halleck* and cited it quoting that "[T]he 'being heavily regulated makes you a state actor' theory of state action is entirely circular and would significantly endanger individual liberty and private enterprise".[64]

I think this is interesting, because for example in the *Harvard* case, it seemed that even a small degree of involvement in the private entity's activities creates a state action. On the other hand, in that case the court was more conservative than in this case.

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[61] *AFBR v. SEC,* p. 8.
[62] *AFBR v. SEC,* p. 14. See also *Lebron v. NRPC* and *DT v. AAR.*
[63] *AFBR v. SEC,* p. 18.
[64] *AFBR v. SEC,* p. 8.

8 A political perspective on board diversity court decisions

The last thing to discuss in this thesis is the composition of the court. In the U.S, there is a common law system in use under which previous court rulings act as a binding law alongside the Constitution and other laws. U.S. Supreme Court cases thus serve in practice as precedents that lower courts such as the 5th Court of Appeals should follow. While it is true that courts must comply with the Constitution, they still affect how the Constitution and other laws are applied and it shapes the case law for subsequent cases.[65] If we consider that precedents are so highly valued, then do the judges not have considerable amount of power? Sure, you can once again appeal to the U.S. Supreme Court, but this leaves us wondering on what grounds judges make their decisions.

Studies suggest that "[i]n ideologically contested cases, a judge's ideological tendency can be predicted by the party of the appointing president; Republican appointees vote very differently from Democratic appointees". In summary, the study found that in certain categories of cases, the composition of the court matters and, in addition, the majority opinion can also influence the decision-making of a minority.[66] In *AFBR v. SEC,* all three judges happened to be comprised by a Democratic president which is relatively unusual for that Circuit, since majority of that court in general has been appointed by a Republican president. But in this particular case, Judge Stewart and Judge Dennis were appointed by Bill Clinton and Judge Higginson was appointed by Barack Obama who both represent the Democratic party.[67] So, could this have any effect on the fact that the decision was completely different from the case of *Meland v. Weber?* Although, in that case, it was a statute, not a "LLC's own rule", but the theme was practically similar. In that case, two judges were appointed by Republican presidents, and one was appointed by a Democrat.[68]

The panel composition effects have also been researched. Jonathan P. Castellac discussed the theory in which the Courts of Appeals, "judges are monitored with respect to the timeliness of their opinions and receive 'credit' for writing majority opinions".[69] This theory is very interesting when looking at the composition of the court in *Meland v. Weber*. Could there also be more dissenting opinions if the judges were encouraged to write them? Or what does this

[65] Farnsworth 1963, p. 35.
[66] Sunstain, et. al. 2004, p. 352–353.
[67] United States Court of Appeals for the Fifth Circuit, 11.3.2024.
[68] United States Courts for the Ninth Circuit, 11.3.2024.
[69] Kastellec 2007, p. 426.

mean for the legal system of the U.S. as a whole? As I mentioned earlier in Section 7, there are many different ways to apply state action tests, depending on the court composition, not to mention that one judge would have to apply it differently and write a dissenting opinion.

Are court rulings based on law and objective judgment (*vis-a-vis a legal model*), political and ideological considerations, or a combination of these? A great question posed by Bartels et. al in their article: Lawyers' Perceptions of the U.S. Supreme Court: Is the Court a "Political" Institution?[70] I wanted to mention the name of this article here as well, as a feature of the entire common law system may also take shape here. Looking at the texts of previous court rulings, are they being examined with the eyes of political glasses? Bartels et. al draw the conclusion that at least this "legal elite" sees the politicization of the courts. But they also criticize the fact that this elite uses this point to draft briefs in cases where they represent their clients.[71]

[70] Bartels, et. al., p. 761.
[71] Bartels, et. al., p. 790.

9 Conclusion: Board Mandates in the United States

The purpose of this research was to determine the legal status of board diversity mandates in today's United States. There is an interesting time in the United States when it comes to racial- or sex-based quotas. It is evident that now the requirements of the constitution and racial quotas seem a little unclear. Of course, the Supreme Court in a common law country such as the United States outlines such legal situations, but if you compare some of the cases, e.g. *SFFA v. Harvard* came out roughly the same time as *AFBR v. SEC.* In *SFFA v. Harvard*, the Supreme Court ruled that we cannot have quotas based on an individual's gender, race or other personal characteristics. The 14th Amendment to the U.S. Constitution explicitly prohibits placing people in a different position compared to others.

So, now that we take a closer look at *AFBR v. SEC,* we can see that the interest in affirmative action in the United States is relatively high. For a long time, the most important functions of society's decision-making bodies have been led by white men. The same applies to management positions in large companies. It seems that the people of the "old covenant" cannot see e.g. women in these important positions, and this is a really damaging viewpoint. I think that this even partially hinders the economic development of companies and, as an important factor, the development of issues such as basic corporate governance within companies. As has been studied, research suggests that diversity significantly improves the various aspects of companies, so management and shareholders should be awake when selecting management teams such as boards of directors.

The effects of corporate board diversity mandates on the corporate's free actioning must be thoroughly investigated as to how such a provision restricts the constitutional freedom of expression or non-discrimination and is compatible with the Constitution in general. My research puts the question under that these regulations may put pressure on companies and their board members to pass on or support certain societal values of inclusion and diversity. Unlike typical corporate governance standards, these regulations go beyond the usual disclosure requirements and force companies implicitly to support certain social and political perspectives on diversity. This change affects not only the company but also current board members and shareholders, raising concerns about possible violations of the Constitutional rights.

If one considers that the speech about diversity is, in a certain way, rather ideological in nature, then the principle of strict scrutiny could apply in an appropriate way. As I mentioned, the Supreme Court has ruled that rules aimed at a certain kind of ideological speech are illegal. The Supreme Court, which is quite Republican dominated, has highlighted freedom of religion and speech as important elements.

As a bigger question, a key objective and a kind of internal goal of law should be that some sort of legal certainty must be guaranteed. James R. Maxeiner stated in a Legal Certainty Conference, that: "Why Germany has Legal Certainty, but America has Legal Indeterminacy?". He discussed the problem about the American perennial issue of legal indeterminacy which, in short, means that the legislation and the modification of the law cannot be anticipated. This is based on the fact that court justices in the United States make decisions and shape the existing law.[72] I also consider that authorities should use their decisions to give individuals a clear picture of their legal position in society in order to achieve the purpose of legal certainty. The current policy of the authorities and court is not sustainable from the point of view of legal certainty. Ensuring legal certainty is hampered by different circumstances and the rapid variation of political viewpoints in U.S. law, which is affected by the composition of the Senate and the incumbent president.

Based on this research, questions remain about, for example, what the purpose of the Constitution is specifically for the acceptance of such board diversity mandates. If we compare European development, quotas reserved for women, for example, are commonplace in many European countries, and such quotas have already been laid down at European union level.[73] However, the application of the US Constitution to positive special treatment has fallen far short of European development and it would therefore be important to look at how the position of women and other groups not presented in top positions in society could be improved in terms of corporate management, or should it be improved? Should it be left to the "effectively functioning market" after all, as some see it? In principle, with such a claim, corporates should become more and more diverse without the state or other entities close to it interfering in development. The research could therefore be related to resolving conflicts related to the freedom to conduct business and the protection of minority groups.

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[72] Maxeiner 2006, p. 520.

[73] Directive (EU) 2022/2381 on improving the gender balance among directors of listed companies and related measures. Adopted 23.11.2022.

After all, the future potential Supreme Court decision should again clarify the definition of "state", and especially the development of diversity in the corporate field. It seems obvious that *Harvard* will also have an impact on *AFBR v. SEC*, if the same Supreme Court handles it later as well. In general, the lawfulness of board diversity, which seems a bit unclear at the moment, will be found out with a high probability later in U.S. Supreme Court case law. Be that as it may, the political debate on this subject will continue to intensify. The long gap between conservatives and liberals deepens and the division of the people of the United States is increasingly visible to the rest of the globe.