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The Burden of Proof in SEC Disciplinary Proceedings: Preponderance and Beyond

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THE BURDEN OF PROOF IN SEC DISCIPLINARY PROCEEDINGS: PREPONDERANCE AND BEYOND

INTRODUCTION

Disciplinary hearings conducted by the Securities Exchange Commission (SEC) are administrative proceedings through which the SEC imposes sanctions on individuals who have violated the Securities Acts.[1] These sanctions are imposed to protect the investing public,[2]

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1. *E.g.*, Touche Ross & Co. v. SEC, 609 F.2d 570 (2d Cir. 1979); Collins Sec. Corp. v. SEC, 562 F.2d 820 (D.C. Cir. 1977); Blaise D'Antoni & Assocs. v. SEC, 289 F.2d 276 (5th Cir.), *cert. denied*, 368 U.S. 899 (1961). The SEC was created by Congress to protect the investing public from fraudulent stock schemes through the enforcement of the Securities Acts, which replaced the existing principle of caveat emptor with a doctrine of full disclosure. *See* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 181, 186 (1963); 1 L. Loss, Securities Regulation 129-30 (2d ed. 1961). The SEC enforces Chapter X of the Bankruptcy Act, originally enacted as 11 U.S.C. §§ 501-676 (current version at scattered sections of 11 U.S.C. (Supp. 1979)), the Securities Act of 1933, §§ 1-13, 15 U.S.C. §§ 77a-77m (1976), the Trust Indenture Act of 1939, §§ 301-28, 15 U.S.C. §§ 77aaa-77bbbb (1976), the Securities Exchange Act of 1934, §§ 1-35, 15 U.S.C. §§ 78a-78kk (1976), the Public Utility Holding Company Act of 1935, §§ 1-32, 15 U.S.C. §§ 79 to 79z-6 (1976), the Investment Company Act of 1940, §§ 1-53, 15 U.S.C. §§ 80a-1 to 80a-52 (1976), and the Investment Advisers Act of 1940, §§ 201-21, 15 U.S.C. §§ 80b-1 to 80b-2 (1976). *See* 17 C.F.R. § 200.2 (1980). Certain violations of the Securities Acts require a showing of willful conduct, while others do not. *Compare* Securities Exchange Act of 1934, §§ 15(b)(4)(d),(e), 19(h)(2), 15 U.S.C. §§ 78o(b)(4)(d),(e), 78s(h)(2) (1976) (willfulness required to prove violation) *and* Investment Company Act of 1940, § 9(b)(1)-(3), 15 U.S.C. § 80a-9(b)(1)-(3) (1976) (same) *and* Investment Advisers Act of 1940, § 203(e)(4)-(5), 15 U.S.C. § 80b-3(e)(4)-(5) (1976) (same) *and* 17 C.F.R. § 201.2(e) (1980) (same) *with* Securities Exchange Act of 1934, § 15(b)(4)(A)-(C), 15 U.S.C. § 78o(b)(4)(A)-(C) (1976) (willfulness not required to prove violation) *and* Investment Company Act of 1940, § 9(b)(1), 15 U.S.C. § 80a-9(b)(1) (1976) (same) *and* Investment Advisers Act of 1940 § 203(e)(1)-(3), 15 U.S.C. § 80b-3(e)(1)-(3) (1976) (same). The term "willful" arising under the Securities Acts is analogous to the tort concept of intent which is merely the desire to do the act. Knowledge that the act is a legal wrong is not required. W. Prosser, Handbook of the Law of Torts, § 8 (4th ed. 1971) *See, e.g., In re* Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965); *In re* Underhill Sec. Corp., 42 S.E.C. 689, 695-96 (1965). *See generally* Mathews, *Litigation and Settlement of SEC Enforcement Proceedings*, 29 Cath. U.L. Rev. 215, 238-41 (1980). Although this Note focuses on individuals and the deprivations they may suffer, corporations are also subject to disciplinary proceedings. *See, e.g.*, Collins Sec. Corp. v. SEC, 562 F.2d 820 (D.C. Cir. 1977); *In re* Walston & Co., Inc., 43 S.E.C. 508 (1967); *In re* J.H. Goddard & Co., 42 S.E.C. 638 (1965).

2. *See* 45 S.E.C. Ann. Rep. 117 (1979); Mathews, *supra* note 1, at 216-17. In 1979 the SEC brought 67 disciplinary proceedings, 511 injunctive actions, and referred 45 cases to the Department of Justice for criminal prosecution. *See* 45 S.E.C. Ann. Rep., *supra*, at 121-22.

the basic goal of the Securities Acts.[3] A significant percentage of the participants in the securities industry are subject to this disciplinary authority. The SEC has the authority to sanction individuals and corporations registered as brokers, dealers, or investment advisers, as well as people associated or attempting to associate with these parties.[4] In addition, the authority itself is broad. The SEC, for example, can

> censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest.[5]

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3. *See* General Sec. Corp. v. SEC, 583 F.2d 1108, 1109 (9th Cir. 1978) (per curiam); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 183 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978); Beck v. SEC, 430 F.2d 673, 674 (6th Cir. 1970); Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Securities Exchange Act of 1934, § 15(b)(4), 15 U.S.C. § 78o(b)(4) (1976); *id.* § 19(h), 15 U.S.C. § 78s(h) (1976); Investment Company Act of 1940, § 9(b), 15 U.S.C. § 80a-9 (1976); Investment Advisers Act of 1940, § 203(3)(e), 15 U.S.C. § 80b-3(e) (1976); S. Rep. No. 792, 73d Cong., 2d Sess. 12-13 (1934).

4. Securities Exchange Act of 1934, §§ 15(a)(4),(6), 15A, 19(h), 15 U.S.C. §§ 78o(b)(4),(6), 78o-3, 78s(h) (1976). The terms broker and dealer have been broadly defined. Generally, any individual or corporation trading in securities is deemed a broker or dealer. *Id.* §§ 3(a)(4),(5), 15 U.S.C. §§ 78c(a)(4),(5) (1976). *See generally* S. Jaffe, Broker-Dealers and Securities Markets § 2.01, at 13-15 (1977); N. Wolfson, R. Phillips & T. Russo, Regulation of Brokers, Dealers and Securities Markets § 1.04, at 1-9 to 1-10 (1977). The Investment Advisers Act of 1940, § 203(e), 15 U.S.C. § 80b-3(e) (1976) authorizes administrative disciplinary proceedings against investment advisers. The definition of investment adviser under the Act overlaps the definitions of brokers and dealers and covers any person in the business of offering investment advice for a fee. *Id.* § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (1976). *See generally* H. Bines, The Law of Investment Management §§ 2.05[2][a]-[c], at 2-30 to 2-35 (1978), Lovitch, *The Investment Advisers Act of 1940—Who is an "Investment Adviser"?*, 24 U. Kan. L. Rev. 67 (1975). The SEC may also sanction investment companies and associated persons. Investment Company Act of 1940, §§ 8-9, 42, 15 U.S.C. §§ 80a-8 to 80a-9, 80a-41 (1976). The term "[c]ompany" in the statute is broadly construed to include a "corporation, a partnership, an association, a joint-stock company, a trust, a fund, or any organized group of persons whether incorporated or not, or any receiver, trustee in [bankruptcy] or similar official or any liquidating agent for any of the foregoing, in his capacity as such." *Id.* § 2(a)(8), 15 U.S.C. § 80a-2(a)(8) (Supp. II 1978). The SEC is attempting to expand further the permissible scope of regulation. *See* H. Bines, *supra*, § 3.04, at 3-67 to 3-72. The SEC can also criminally prosecute or civilly enjoin violators of the Acts as an alternative to administrative hearings and sanctions. 15 U.S.C. § 77t (1976) (violations of the 1933 Act); *id.* § 77uuu (trustees), *id.* § 78u (violations of the 1934 Act); *id.* § 79r (public utilities corporations and their subsidiaries); *id.* § 80a-41 (investment companies); *id.* § 80b-9 (investment advisers).

5. Securities Exchange Act of 1934, § 15(b)(4), 15 U.S.C. § 78o(b)(4) (1976). Other sanctions available to the SEC include revocation of a party's membership in

Moreover, the SEC may deny attorneys, accountants, engineers, and other professionals "temporarily or permanently, the privilege of appearing or practicing before it in any way."[6]

In light of the punitive nature of these disciplinary hearings, a question has arisen concerning the burden of proof[7] that the SEC

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one of the national stock exchanges or securities associations, *id.* § 19(h)(3), 15 U.S.C. § 78s(h)(3) (1976), and barring a party from associating with other members of a national securities exchange or securities association. *Id.*, 15 U.S.C. § 78s(h)(3) (1976). The SEC can also impose restitutionary remedies on parties through consent decrees. *See, e.g., In re* Bateman, Eichler, Hill Richards, Inc., SEC 1934 Act Release No. 14579 (Mar. 20, 1978); *In re* Merrill Lynch, Pierce, Fenner & Smith, Inc., SEC 1934 Act Release No. 14149 (Nov. 9, 1977), [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,365; *In re* Government Employees Ins. Co., SEC 1934 Act Release No. 12930 (Oct. 27, 1976), [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,750; *In re* Financial Programs, Inc., SEC 1934 Act Release No. 11312 (Mar. 24, 1975), [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,146. *See generally* Sporkin, *SEC Developments in Litigation and the Molding of Remedies*, 29 Bus. Law. 121 (1974). The SEC also has the power to review disciplinary sanctions imposed by the National Association of Securities Dealers, national stock exchanges, and other regulatory or quasi-governmental agencies. Securities Exchange Act of 1934, §§ 15A, 15B, 17A, 19, 15 U.S.C. §§ 78o-3, 78o-4, 78q-1, 78s (1976).

6. 17 C.F.R § 201.2(e) (1980) (Rule 2(e) of the SEC's Rules of Practice). The validity and scope of Rule 2(e), especially as applied to attorneys, has been the subject of debate. *See* Touche Ross & Co. v. SEC, 609 F.2d 570, 578-82 (2d Cir. 1979); *In re* Keating, Muething & Klekamp, SEC 1934 Act Release No. 15982 (July 2, 1979), [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,124 (Karmel, dissenting). *See generally* Bialkin, *Sanctions Against Accountants*, 8 Rev. Sec. Reg. 823 (1975); Burton, *SEC Enforcement and Professional Accountants: Philosophy, Objectives and Approach*, 28 Vand. L. Rev. 19 (1975); Daley & Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 Emory L.J. 747 (1975); Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC: Disciplinary Hearings Under Rule 2(e) of the Commission's Rule of Practice*, 25 Mercer L. Rev. 637 (1974); Mathews, *supra* note 1, at 225-226; Miller, *The Distortion and Misuse of Rule 2(e)*, 7 Sec. Reg. L.J. 54 (1979).

7. Burdens of proof " 'instruct the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication.' " Addington v. Texas, 441 U.S. 418, 422 (1979) (quoting *In re* Winship, 397 U.S. 358, 370 (1970) (Harlan, J., concurring)). The term burden of proof has two independent meanings. In one sense it is used to denote the degree to which a factfinder must be subjectively persuaded, based upon the evidence presented, that a particular fact exists. *See, e.g.*, Speiser v. Randall, 357 U.S. 513, 525-26 (1958) (beyond a reasonable doubt); Hobson v. Eaton, 399 F.2d 781, 784-85 (6th Cir. 1968) (clear and convincing), *cert. denied*, 394 U.S. 928 (1969); Carpenter v. Union Ins. Soc'y Ltd., 284 F.2d 155, 162 (4th Cir. 1960) (same); Norton v. Futrell, 149 Cal. App. 2d 586, 591-92, 308 P.2d 887, 891 (1957) (preponderance of the evidence). For a general discussion of burden of proof as a degree of persuasion, see F. James & G. Hazard, Civil Procedure §§ 7.5 to .8 (2d ed. 1977); McCormick's Handbook of the Law of Evidence §§ 336-341 (2d ed. E. Cleary 1972) [hereinafter cited as McCormick]; 9 J. Wigmore, Evidence §§ 2497-98 (3d ed. 1940 & Supp. 1980); Kaplan, *Decision Theory and the Factfinding Process*, 20 Stan. L. Rev. 1065 (1968); Ligertwood, *The Uncertainty of Proof*, 10 Melbourne U.L. Rev. 367 (1976);

must meet to prove violations of the anti-fraud provisions of the Securities Acts[8] that potentially result in the imposition of severe sanctions. Traditionally, the SEC has applied a preponderance of the evidence burden of proof,[9] rather than the more stringent clear and convincing[10] or beyond a reasonable doubt[11] standards. The applica-

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McBaine, *Burdens of Proof: Degrees of Belief*, 32 Cal. L. Rev. 242 (1944); McNaughton, *Burden of Production of Evidence: A Function of a Burden of Persuasion*, 68 Harv. L. Rev. 1382 (1955). The term burden of proof may also refer to the duty of a particular party to come forward with evidence to prove a particular fact. This duty is generally placed on the party seeking to change the status quo, usually the plaintiff or prosecutor. *See, e.g.*, Speiser v. Randall, 357 U.S. 513, 523 (1958); Palmer v. Hoffman, 318 U.S. 109, 117-19 (1943); Hobson v. Eaton, 399 F.2d 781, 785 (6th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969). For a discussion of the burden of proof in the context of which party must come forward with evidence, see M. Green, Basic Civil Procedure 110-13 (2d ed. 1979); McCormick, *supra*, § 338; 9 J. Wigmore, *supra*, §§ 2487-89. Unless otherwise indicated, this Note uses the term burden of proof as a degree of persuasion.

8. Securities Act of 1933, § 17(a), 15 U.S.C. § 77q(a) (1976); Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78(j) (1976); 17 C.F.R. § 240.10b-5 (1980). The fraud provisions of the Securities Acts are commonly called the anti-fraud provisions. *See* Aaron v. SEC, 100 S. Ct. 1945, 1959 (1980) (Blackmun, J., concurring in part, dissenting in part); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 199 (1963). For a general discussion of the concept of securities fraud, see 3 L. Loss, Securities Regulation 1422-44 (2d ed. 1961).

9. *See, e.g., In re* M.V. Gray Investments, Inc., 44 S.E.C. 567, 575 (1971); *In re* Pollisky, 43 S.E.C. 458, 459-60 (1967); *In re* Underhill Sec. Corp., 42 S.E.C. 689, 695 (1965); *In re* White, 3 S.E.C. 466, 539-40 (1938). Proof by a preponderance or weight of the evidence is the common standard for civil proceedings. 9 J. Wigmore, *supra* note 7, § 2498. Under this standard the trier of fact "must believe that it is more probable that the facts are true or exist than it is that they are false or do not exist; but, it is not necessary to believe that there is a high probability that they are true or exist, or necessary to believe to a point of almost certainty, or beyond a reasonable doubt, that they are true or exist, or necessary to believe that they certainly are true or exist." McBaine, *supra* note 7, at 261; *see* McCormick, *supra* note 7, § 339, at 794-95. Other administrative agencies have also used a preponderance standard. *E.g.*, Walters v. McLucas, 597 F.2d 1230, 1232 (9th Cir.) (FAA revocation of pilots license), *cert. denied*, 444 U.S. 932 (1979); Alsbury v. United States Postal Serv., 530 F.2d 852, 855 (9th Cir.) (discharge of postal employee), *cert. denied*, 429 U.S. 828 (1976); Kephart v. Richardson, 505 F.2d 1085, 1089 (3d Cir. 1974) (termination of disability payments by HEW); Polcover v. Secretary of the Treasury, 477 F.2d 1223, 1231 (D.C. Cir.) (IRS discharge of employee), *cert. denied*, 414 U.S. 1001 (1973). *But see* Sea Island Broadcasting Corp. v. FCC, 47 Ad. L.2d 831, 835-37 (D.C. Cir. 1980) (clear and convincing standard for FCC revocation of broadcasting license).

10. The intermediate burden of proof standard, that of clear and convincing evidence, reduces the probability that an innocent party will be held liable. *See* Addington v. Texas, 441 U.S. 418, 432 (1979); *In re* Winship, 397 U.S. 358, 369-70 (1970) (Harlan, J., concurring). This standard requires a belief by the factfinder "that it is highly probable that the facts are true or exist; while it is not necessary to believe to the point of almost certainty, or beyond a reasonable doubt that they are true or exist, or that they certainly are true or exist; yet it is not sufficient to believe that it is merely more probable that they are true or exist than it is that they are false or do not exist." McBaine, *supra* note 7, at 262-63; *see* Dacey v. Connecticut Bar Ass'n,

bility of the preponderance standard, which equally allocates the risk of error between the litigants,[12] was recently upheld by the Fifth Circuit in *Steadman v. SEC.*[13] Although the appellant argued that a higher burden of proof should be applied, the court held that the preponderance standard adequately protected the interests of those individuals facing the potential imposition of sanctions.[14]

The District of Columbia Circuit, however, has expressly rejected the preponderance burden of proof because of the nature of the sanctions available to the SEC. Focusing on the effect of the more severe sanctions upon the individual's liberty interest, this Circuit has concluded that a higher standard, that of clear and convincing evidence, is applicable in SEC disciplinary hearings.[15] Under this intermediate

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170 Conn. 520, 536-37, 368 A.2d 125, 135 (1976); J. Maguire, Evidence 180-81 (1947); McCormick, *supra* note 7, § 340(b), at 796-98; J. Weinstein, Basic Problems of State and Federal Evidence 17 (5th ed. 1976). This intermediate standard is also applied to proceedings in which a party attempts to prove fraud, undue influence, the contents of a lost will or deed, a parol gift, a mutual mistake sufficient to allow a court to reform a contract, and to impeach a notary's certificate. 9 J. Wigmore, *supra* note 7, § 2498. The phrases clear and convincing; clear, unequivocal and convincing; convincing proof; and clear and substantial have all been used to indicate an intermediate standard. *See id.*

11. The beyond a reasonable doubt burden of proof is generally used in criminal proceedings. McCormick, *supra* note 7, § 341; 9 J. Wigmore, *supra* note 7, § 2497. When the criminal standard is used, "[s]ociety imposes almost the entire risk of error upon itself." Addington v. Texas, 441 U.S. 418, 424 (1979); *see* Mullaney v. Wilbur, 421 U.S. 684, 705-06 (1975) (Rehnquist, J., concurring); Underwood, *The Thumb on the Scales of Justice: Burdens of Persuasion in Criminal Cases*, 86 Yale L.J. 1299, 1302-04 (1977). This high standard of persuasion, however, is not required in every aspect of a criminal proceeding. *E.g.*, Lego v. Twomey, 404 U.S. 477, 482-87 (1972) (voluntariness of a criminal confession for the purposes of admission into evidence need only be shown by a preponderance of the evidence). The criminal standard has also been applied to at least one civil proceeding that results in the imposition of extreme sanctions. *See* United States *ex rel.* Stachulak v. Coughlin, 520 F.2d 931, 935-37 (7th Cir. 1975) (involuntary civil commitment for sexual dangerousness), *cert. denied*, 424 U.S. 947 (1976).

12. Addington v. Texas, 441 U.S. 418, 423 (1979). "At one end of the spectrum is the typical civil case involving a monetary dispute between private parties. Since society has a minimal concern with the outcome of such private suits, plaintiff's burden of proof is a mere preponderance of the evidence. The litigants thus share the risk of error in roughly equal fashion." *Id.*

13. 602 F.2d 1126 (5th Cir. 1979), *cert. granted*, 100 S. Ct. 1849 (1980) (No. 79-1266).

14. *Id.* at 1139. The defendant in the SEC disciplinary hearing petitioned for certiorari, and it was granted. Steadman v. SEC, 100 S. Ct. 1849 (1980) (No. 79-1266).

15. Whitney v. SEC, 604 F.2d 676, 680-81 (D.C. Cir. 1979); Collins Sec. Corp. v. SEC, 562 F.2d 820, 824 (D.C. Cir. 1977). *Compare* 47 U. Cin. L. Rev. 147 (1978) (approving of the application of the clear and convincing standard to SEC disciplinary proceedings) *with* 93 Harv. L. Rev. 1845 (1980) (criticizing the application of the clear and convincing standard) *and* 12 Ga. L. Rev. 153 (1978) (same).

standard of clear and convincing evidence, the factfinder must believe that it is highly probable that the contested factual assertion is true.[16]

Although the District of Columbia Circuit cases have been decided as a matter of policy,[17] the imposition of a higher standard would be mandatory if it is determined that the present procedural protection is inadequate to satisfy the mandates of the due process clause of the fifth amendment.[18] Procedural due process is the ultimate safeguard against administrative unfairness.[19] When administrative agencies seek to impose sanctions that infringe upon an individual's liberty or property, certain procedural safeguards are constitutionally required. These safeguards become more or less rigorous[20] depending upon a balancing of three competing interests:[21] the effect of the governmental action upon the individual's constitutionally protected interests;[22] the fairness of the existing proceeding and the probable effect that any additional procedural safeguards will have in increasing the accuracy of the proceeding and further decreasing the risk of an erroneous deprivation of the individual's rights;[23] and the governmental interests implicated in the proceeding, including the administrative feasibility of implementing additional procedures.[24] This Note will apply the procedural due process balancing test to the imposition

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16. *See* note 10 *supra*.

17. *See* Whitney v. SEC, 604 F.2d 676, 680-681 (D.C. Cir. 1979), Collins Sec. Corp. v. SEC, 562 F.2d 820, 824 (D.C. Cir. 1977). Setting the burden of proof has traditionally been left to the discretion of the courts. Woodby v. Immigration and Naturalization Serv., 385 U.S. 276, 284 (1966); *see, e.g.*, First Va. Bankshares v. Benson, 559 F.2d 1307, 1320 (5th Cir. 1977), *cert. denied*, 435 U.S. 952 (1978); Coffee v. Permian Corp., 474 F.2d 1040, 1043-44 (5th Cir.), *cert. denied*, 412 U.S. 920 (1973).

18. "[N]o person shall . . . be deprived of life, liberty, or property, without due process of law . . . ." U.S. Const. amend. V. The due process clause of the fifth amendment applies only to the federal government while the due process clause of the fourteenth amendment applies to the states. Although this Note focuses on federal enforcement of the Securities Acts, its analysis also may be applied to the local enforcement of state securities laws, commonly referred to as "blue sky" laws.

19. *See* National Ass'n of Recycling Indus. v. ICC, 627 F.2d 1328, 1334 (D.C. Cir. 1980); Gilbert v. Johnson, 601 F.2d 761, 766 (5th Cir. 1979), *cert. denied*, 445 U.S. 961 (1980); *cf.* Cantwell v. Connecticut, 310 U.S. 296, 306 (1940) (a statute authorizing the judicial restraint of constitutional rights is "as obnoxious to the Constitution as one providing for like restraint by administrative action").

20. *See* Morrissey v. Brewer, 408 U.S. 471, 481 (1972) ("due process is flexible and calls for such procedural protections as the particular situation demands"); Cafeteria & Restaurant Workers Local 473 v. McElroy, 367 U.S. 886, 895 (1961) (" '[d]ue process,' unlike some legal rules, is not a technical conception with a fixed content unrelated to time, place and circumstances") (quoting Joint Anti-Facist Refugee Comm. v. McGrath, 341 U.S. 123, 162 (1961) (Frankfurter, J., concurring)).

21. Mathews v. Eldridge, 424 U.S. 319, 335-44 (1976).

22. *Id.* at 335, 339-43.

23. *Id.* at 343-37.

24. *Id.* at 348-49.

of sanctions pursuant to SEC disciplinary hearings and conclude that the SEC's use of a preponderance burden of proof is constitutionally defective in light of the potential deprivations resulting from the imposition of severe sanctions by the SEC.

I. The Individual Interests

A. *The Interests Defined*

The first prong of the balancing test requires an examination of the individual property and liberty interests that are infringed upon by the governmental action.[25] Focusing on this factor in *Addington v. Texas*,[26] the Supreme Court held that the possible deprivation of physical liberty inherent in an involuntary commitment proceeding[27] mandated the use of a clear and convincing burden of proof.[28] Although an individual is not deprived of his physical liberty as a result of a SEC disciplinary proceeding, the imposition of sanctions can deprive him of other significant liberty interests.[29]

The severe SEC sanctions of license revocation, disbarment from appearing before the SEC, and permanent bar from associating with other securities professionals,[30] prevent the individual from engaging in his chosen profession.[31] Without a license, an individual can no longer act as a broker, dealer, or investment adviser.[32] If an attorney, accountant, or engineer is precluded from appearing before the SEC, he cannot represent clients engaged in the securities industry[33] and thus is excluded from further securities practice. Similarly, a pro-

25. *Id.* at 335.

26. 441 U.S. 418 (1979).

27. *Id.* at 433.

28. *Id.* at 421.

29. Whitney v. SEC, 604 F.2d 676, 680 n.14, 681 (D.C. Cir. 1979); Collins Sec. Corp. v. SEC, 562 F.2d 820, 824-26 (D.C. Cir. 1977); *cf.* Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 n.6 (2d Cir. 1976) (disciplinary actions visit serious consequences on the party), *cert. denied*, 434 U.S. 1009 (1978); SEC v. National Student Mkt'g Corp., 457 F. Supp. 682, 701 n.43 (D.D.C. 1978) (an injunction is a less severe deprivation than disciplinary sanctions). *See generally* note 36 *infra*.

30. *See* notes 5, 6, *supra* and accompanying text.

31. Whitney v. SEC, 604 F.2d 676, 680-81 (D.C. Cir. 1979); Collins Sec. Corp. v. SEC, 562 F.2d 820, 824-26 (D.C. Cir. 1977).

32. *See, e.g.*, Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162 (9th Cir. 1960), *cert. denied*, 366 U.S. 919 (1961). The Securities Acts require, with few exceptions, that all securities professionals be registered or licensed. Securities Exchange Act of 1934, § 15(b), 15 U.S.C. § 78o(a) (1976) (requiring the registration of any individual or company selling securities and providing exceptions for exclusively interstate sales and exempt securities sales); Investment Company Act of 1940, § 8, 15 U.S.C. § 80a-8 (1976) (voluntary registration); Investment Advisers Act of 1940, § 203(a)-(b), 15 U.S.C. § 80b-3(a)-(b) (1976) (requiring the registration of investment advisers with exception made for advice given for intrastate operations to insurance companies and to small numbers of clients on a private basis).

33. *See* note 6 *supra*.

larly, a prohibition against associating with other securities professionals precludes the individual from further employment in the field. The purposes of these sanctions predetermine their results. By preventing an individual from engaging in any aspect of the securities industry, these sanctions deprive him of his right to pursue a livelihood,[34] a constitutionally protected interest that cannot be impaired absent procedural due process safeguards.[35]

Courts have frequently applied a higher burden of proof in analogous proceedings that potentially result in the deprivation of a significant interest.[36] In the situation of attorney disbarment, for example, a majority of the courts have recognized that the effect of disbarment on the attorney's right to pursue a livelihood requires greater procedural protection than that which a mere preponderance standard provides.[37] In deportation proceedings, the Supreme Court has ap-

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34. *See* Whitney v. SEC, 604 F.2d 676, 680 (D.C. Cir. 1979); Collins Sec. Corp. v. SEC, 562 F.2d 820, 824-26 (D.C. Cir. 1977).

35. Hampton v. Mow Sun Wong, 426 U.S. 88, 102-03 (1976); Arnett v. Kennedy, 416 U.S. 134, 148-55 (1974); Willner v. Committee on Character and Fitness, 373 U.S. 96, 103 (1963); Schware v. Board of Bar Examiners, 353 U.S. 232, 238-39 (1957); R. Rabin, Perspectives on the Administrative Process 49-65 (1979); *cf.* Barry v. Barchi, 443 U.S. 55, 63-66 (1979) (lack of a prompt post-suspension hearing after the revocation of horse trainer's license violates procedural due process), Dixon v. Love, 431 U.S. 105, 112 (1977) ("due process requires an evidentiary hearing prior to the deprivation of some type of property interest") (quoting Mathews v. Eldridge, 424 U.S. 319, 333 (1976)); Goss v. Lopez, 419 U.S. 565, 579 (1975) (notice and hearing required in an administrative proceeding to suspend high school students to protect their property interest in education); Bell v. Burson, 402 U.S. 535, 542-43 (1971) (lack of a pre-suspension hearing before revocation of driver's license violates procedural due process). *See generally* B. Schwartz, Constitutional Law § 8.11 (2d ed. 1979); L. Tribe, American Constitutional Law §§ 3-19, 15-14 (1978); Monaghan, *Of "Liberty" and "Property,"* 62 Cornell L. Rev. 405 (1977); Reich, *The New Property*, 73 Yale L.J. 733, 734-35 (1964). The label given to the interest infringed by disciplinary proceedings is not determinative because both liberty and property are protected by the Constitution. U.S. Const. amend. V; *see* Wolff v. McDonnell, 418 U.S. 539, 557-58 (1974) (the "analysis as to liberty parallels the accepted due process analysis as to property"); Lynch v. Household Fin. Corp., 405 U.S. 538, 552 (1972) ("Property does not have rights. People have rights . . . a fundamental interdependence exists between the personal right to liberty and the personal right in property.").

36. *E.g.*, Jackson v. Virginia, 443 U.S. 307, 309 (1979) (criminal proceeding), Addington v. Texas, 441 U.S. 418, 425-27 (1979) (involuntary civil commitment); Mullaney v. Wilbur, 421 U.S. 684, 704 (1975) (criminal proceeding); Gertz v. Robert Welch, Inc., 418 U.S. 323, 342 (1974) (defamation actions); *In re* Winship, 397 U.S. 358, 365-68 (1970) (juvenile delinquency); Chaunt v. United States, 364 U.S. 350, 353 (1960) (denaturalization); Nowack v. United States, 356 U.S. 660, 663 (1958) (denaturalization); Nishikawa v. Dulles, 356 U.S. 129, 135 (1958) (expatriation), Gonzales v. Landon, 350 U.S. 920, 920 (1955) (per curiam) (expatriation).

37. *See In re* Fisher, 179 F.2d 361, 370 (7th Cir.), *cert. denied*, 340 U.S. 825 (1950); *In re* Ryder, 263 F. Supp. 360, 361 (E.D.Va.), *aff'd per curiam*, 381 F.2d 713 (9th Cir. 1967); People *ex rel.* Cline v. Kerker, 315 Ill. 572, 574, 146 N.E. 439, 439 (1925); Attorney Grievance Comm'n v. Bailey, 285 Md. 631, 644, 403 A.2d 1261,

plied a clear, unequivocal, and convincing standard[38] because of the loss of liberty engendered by the forced relocation of the individual and the resultant loss of contemporary ties.[39]

When an individual is permanently barred from associating with other securities professionals, the deprivation can be at least as severe as those imposed by deportation because the exclusion of the sanctioned party from his profession vitiates his relationship with his contemporary business ties.[40] When compared to attorney disbarment, the deprivation may even be more severe because an SEC sanction is effective nationwide,[41] whereas a state may only prevent an attorney from practicing within its jurisdiction.[42] Thus, an indi-

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1268 (1979); *cf. In re* Ruffalo, 390 U.S. 544, 551 (1968) (disciplinary proceedings "are adversary proceedings of a quasi-criminal nature," and disbarment, designed to protect the public, is a punishment or penalty imposed on the lawyer); *Ex parte* Wall, 107 U.S. (17 Otto) 265, 288 (1882) (disbarment of attorneys is permissible only in the clearest cases of misconduct to protect the integrity of the court); McComb v. Commission on Judicial Performance, 19 Cal. 3d Spec. Trib. Supp. 1, 6, 138 Cal. Rptr. 459, 464, 546 P.2d 1, 6 (1977) (clear and convincing evidence needed to remove a judge from the bench), State *ex rel.* Vining v. Florida Real Estate Comm'n, 281 So. 2d 487, 491 (Fla. 1973) (revocation of a professional license affects the individual's livelihood and reputation subjecting such proceedings to a higher scrutiny); Mississippi Real Estate Comm'n v. Ryan, 248 So. 2d 790, 793 (Miss. 1971) (fraudulent dealing must be clearly established to revoke a license); Margoles v. State Bd. of Medical Examiners, 47 Wis. 2d 499, 509, 177 N.W.2d 353, 358 (1970) (to revoke a medical license "procedural due process often requires confrontation and cross-examination of those whose word deprives a person of his livelihood"). *See generally* ABA Center for Professional Discipline, Disciplinary Law and Procedure Research System (1981); ABA Joint Committee on Professional Discipline, Professional Discipline for Lawyers and Judges 78-81, 130 (1979); Note, *Disbarment in the United States: Who Shall do the Noisome Work?*, 12 Colum J.L. & Soc. Prob. 1 (1975). Other administrative agencies have also disbarred attorneys from practicing before them. *E.g.*, Goldsmith v. United States Bd. of Tax Appeals, 270 U.S. 117 (1926) (Internal Revenue Service); Koden v. United States Dep't of Justice, 564 F.2d 228 (7th Cir. 1977) (Immigration and Naturalization Service); Herman v. Dulles, 205 F.2d 715 (D.C. Cir. 1953) (International Claims Commission).

38. Woodby v. Immigration and Naturalization Serv., 385 U.S. 276, 285-86 (1966).

39. "The immediate hardship of deportation is often greater than that inflicted by denaturalization, which does not, immediately at least, result in the expulsion from our shores. And many resident aliens have lived in this country longer and established stronger family, social, and economic ties here than some who have become naturalized citizens." *Id.* at 286.

40. *See* Whitney v. SEC, 604 F.2d 676, 681 (D.C. Cir. 1979); Steadman v. SEC, 603 F.2d 1126, 1139 (5th Cir. 1979), *cert. granted*, 100 S. Ct. 1849 (1980); L. Jaffe, Judicial Control of Administrative Action 267-68 (1965); Lacy, *Adverse Publicity and SEC Enforcement Procedure*, 46 Fordham L. Rev. 435, 435 (1977).

41. *See* S. Jaffe, *supra* note 4, § 1.04; Thomforde, *Controlling Administrative Sanctions*, 74 Mich. L. Rev. 709, 711 (1976).

42. Although the disbarment of an attorney in one state can lead to disbarment in another state in which the individual is also licensed to practice, nationwide disbarment is not certain. *See* Theard v. United States, 354 U.S. 278, 282 (1957)

vidual subject to SEC sanctions should be afforded the same procedural protection as attorneys facing disbarment, and aliens facing deportation.

" '[L]iberty' is [also] implicated and procedural due process is required when government action threatens an [individual's] good name, reputation, honor, or integrity."[43] Such a situation arises when an individual is sanctioned by the SEC on findings of fraudulent conduct.[44] Courts have long recognized that allegations of fraud connote corruption and moral turpitude[45] and " 'might seriously damage [one's] standing and associations in [the] community.' "[46] Consequently, the courts have imposed an intermediate burden of proof in civil fraud cases[47] in recognition of the "adverse social consequences

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("[D]isbarment by federal courts does not automatically flow from disbarment by state courts."); Florida Bar v. Wilkes, 179 So. 2d 193, 198 (Fla. Dist. Ct. App. 1965) (as a matter of interstate comity or pursuant to the full faith and credit clause of the Constitution, disbarment of an individual by a sister state may be held to be conclusive, but the forum state may choose not to follow the other state's judgment if it is deemed "so deficient or lacking in notice or opportunity to be heard, that there was such a paucity of proof, or that there was some other grave reason which would make it unjust to accept the foreign judgment"), *cert. denied*, 390 U.S. 983 (1968), *In re* Kimball, 40 A.D.2d 252, 254, 339 N.Y.S.2d 302, 305 (1973) (the court did not give full faith and credit to the disbarment of an individual by another state because "[r]easons of policy regarded as significant in one State . . . may not prevail in another State"). In the instances of both attorney disbarment and SEC sanctioning, the individual is not disbarred forever. The SEC, acting pursuant to 17 C.F.R. § 240.15ab-1 (1980), may reinstate parties who have been excluded from the industry by its sanctions. Securities Exchange Act Release No. 11267 (Feb. 26, 1975), [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,115; Investment Company Act Release No. 8689 (Feb. 26, 1975), [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,115; Investment Advisers Act Release No. 438 (Feb. 26, 1975), [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,115; *see* Tager v. SEC, 344 F.2d 5, 9 (2d Cir. 1965). The state and federal bars also permit reinstatement. *See, e.g.*, Levenson v. Mills, 294 F.2d 397, 399 (1st Cir. 1961), *cert. denied*, 368 U.S. 954 (1962); *In re* Spriggs, 90 Ariz. 387, 388, 368 P.2d 456, 457 (1962); *In re* Hiss, 368 Mass. 447, 453, 333 N.E.2d 429, 434 (1975).

43. McNeill v. Butz, 480 F.2d 314, 319 (4th Cir. 1973).

44. *See* Whitney v. SEC, 604 F.2d 676, 681 (D.C. Cir. 1979); Collins Sec. Corp. v. SEC, 562 F.2d 820, 825 (D.C. Cir. 1977).

45. Jordan v. De George, 341 U.S. 223, 227-28 (1951), United States Steel Corp. v. Darby, 516 F.2d 961, 963 (5th Cir. 1975); Lozano-Giron v. Immigration and Naturalization Serv., 506 F.2d 1073, 1076 (7th Cir. 1974), McNeill v. Butz, 480 F.2d 314, 319-20 (4th Cir. 1973).

46. McNeill v. Butz, 480 F.2d 314, 319 (4th Cir. 1973) (quoting Board of Regents v. Roth, 408 U.S. 564, 573 (1972)).

47. Lalone v. United States, 164 U.S. 255, 261 (1896), Maxwell Land-Grant Case, 121 U.S. 325, 380-82 (1887); Barr Rubber Prods. Co. v. Sun Rubber Co., 425 F.2d 1114, 1120 (2d Cir.), *cert. denied*, 400 U.S. 878 (1970), Goodman v. Poland, 395 F. Supp. 660, 686 n.17 (D. Md. 1975); Pinney & Topliff v. Chrysler Corp., 176 F. Supp. 801, 803 (S.D. Cal. 1959); Yoo Hoo Bottling Co. v. Leibowitz, 432 Pa. 117, 119, 247 A.2d 469, 470 (1968) (per curiam); Beckett v. Department of Social Health Servs., 87 Wash. 2d 184, 186-87, 550 P.2d 529, 531 (1976). The standard of clear and

to the individual"[43] engendered by such proceedings.

Although securities fraud is a broader concept than common law fraud,[49] the stigma occasioned by an administrative finding of securities fraud is equivalent to that occasioned by common law fraud. The finding of fraud, whether in a civil forum or a SEC disciplinary hearing, still connotes dishonesty and disgrace.[50] Even the mere characterization of the violation as fraud is sufficient to allow the investing public to draw a stigmatizing inference.[51]

Moreover, the certainty of being stigmatized is greater when dealing with securities fraud than with common law fraud. Information is disseminated rapidly in the securities industry.[52] This is heightened

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convincing evidence has also been applied in federal tax fraud proceedings. *See, e.g.*, Mensik v. Commissioner, 328 F.2d 147, 150 (7th Cir.), *cert. denied*, 379 U.S. 827 (1964); Lessman v. Commissioner, 327 F.2d 990, 993 (8th Cir. 1964); Kurnick v. Commissioner, 232 F.2d 678, 681 (6th Cir. 1956).

48. Addington v. Texas, 441 U.S. 418, 426 (1979). Some courts have imposed the clear and convincing standard to ensure a presumption of honesty and fair dealing on the part of all individuals. *See, e.g.*, United States v. Wunderlich, 342 U.S. 98, 100 (1951); United States v. Colorado Anthracite Co., 225 U.S. 219, 226 (1912); Plantation Key Developers v. Colonial Mortgage Co., 589 F.2d 164, 172 (5th Cir. 1979).

49. *See* Aaron v. SEC, 446 U.S. 680, 697 (1980); 3 L. Loss, *supra* note 8, at 1421-46. The concept of fraud under the Securities Acts is flexible to meet the challenge of protecting the investing public from "a certain class of gentleman [who] . . . would lie awake nights endeavoring to conceive some devious and shadowy way of evading the law." State v. Whiteaker, 118 Or. 656, 661, 247 P. 1077, 1079 (1926).

50. *See* Ross v. A. H. Robbins Co., 607 F.2d 545, 557 (2d Cir. 1979); Whitney v. SEC, 604 F.2d 676, 680-81 (D.C. Cir. 1979); Gilbert v. Bagley, 492 F. Supp. 714, 725 (M.D.N.C. 1980); Rich v. Touche Ross & Co., 68 F.R.D. 243, 245 (S.D.N.Y. 1975).

51. *See* Arenson, *Ruin of 2 Wall Street Careers*, N.Y. Times, Feb. 14, 1981, at 29, col. 3. The word "fraud" itself connotes moral turpitude. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193-94 (1963); United States v. Snider, 502 F.2d 645, 650-52 (4th Cir. 1974); Sherwood & Roberts-Kennewick, Inc. v. St. Paul Fire & Marine Ins. Co., 322 F.2d 70, 73-75 & n.4 (9th Cir. 1963). *See generally* Webster's New International Dictionary 1003 (2d ed. 1957) (defining fraud as the "quality of being deceitful").

52. "Much of securities law is intended to reduce speculation in stock. Yet in stock trading as elsewhere, speculation serves the salutary purpose of enabling rapid adjustments of prices to current values. The speculator is the eager searcher for undervalued and overvalued securities. The information that he uncovers diffuses rapidly throughout the market . . . enabling other traders to adjust as rapidly as possible to the changed conditions discovered by the speculator." R. Posner, Economic Analysis of Law 333-34 (2d ed. 1977). "The adverse publicity resulting from the institution of public enforcement proceedings may have as severe an impact on the respondent or defendant as any formal sanction ultimately imposed." Lacy, *supra* note 40, at 441. "The daily operations of the securities industry depend on reputation and trust. Persons subject to SEC regulation must strive for its favor, because they are confronted with regulations administered by it at every turn, and because the agency has broad discretion in administering those legal requirements. Hence, those subject to SEC regulation will avoid association with targets of the agency's suspicions." *Id.* at 435 (footnotes omitted). Moreover, newspapers publicize the allegations

by the SEC's statutory authority to conduct public disciplinary hearings[53] and to circulate investigatory reports prior to taking disciplinary action.[54] Thus, as soon as an individual is adjudged to have violated the anti-fraud provisions of the Securities Acts, it is likely that this result will become known to investors with whom the individual transacts business.

The stigma caused by governmental action, however, does not in itself justify the imposition of further procedural safeguards.[55] Stigma when combined with the deprivation of another significant liberty interest is sufficient to compel additional due process protection.[56] In the case of SEC disciplinary hearings, the concomitant deprivation of livelihood engendered by the imposition of sanctions constitutes a deprivation of liberty sufficient to compel raising the burden of proof.

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made by the SEC in its disciplinary action. *See, e.g.*, N.Y. Times, April 29, 1977, § D, at 1, col. 1. *See also* Lacy, *supra* note 40, at 441-42.

53. 17 C.F.R. §§ 200.400-402 (1980); *see* Gellhorn, *Adverse Publicity by Administrative Agencies*, 86 Harv. L. Rev. 1380, 1397 & n.64 (1973) (listing the criteria applied by the SEC to determine whether to publicize its disciplinary proceedings by holding a public instead of a private hearing).

54. Securities Exchange Act of 1934, § 21(a), 15 U.S.C. § 78u(a) (1976). The SEC can also publish reports of investigations that do not lead to criminal, civil or disciplinary action as an enforcement tool. Mathews, *supra* note 1, at 226-29. The SEC may also issue press releases to announce the institution of disciplinary proceedings. 17 C.F.R. § 201.6(c) (1980). This added publicity may increase the extent to which the individual is deprived of his liberty. As the Supreme Court noted, "the degree of potential deprivation that may be created by a particular decision is a factor to be considered in assessing the validity of any administrative decisionmaking process." Mathews v. Eldridge, 424 U.S. 319, 341 (1976). For a more detailed analysis of the potential injuries to reputation and business engendered by the adverse publicity of SEC proceedings, see Securities Exchange Commission Advisory Committee on Enforcement Policies and Practices Report 28 (1972) [hereinafter cited as Enforcement Report], *reprinted in* A. Mathews, B. Finkelstein, & H. Milstein, Enforcement and Litigation Under the Federal Securities Laws 313 (1973) [hereinafter cited as Enforcement and Litigation]; Gellhorn, *supra* note 53, at 1394-98; Lacy, *supra* note 40, at 441-458.

55. Paul v. Davis, 424 U.S. 693, 712 (1976). The Court has taken a far more restrictive view of the constitutional questions involved when a stigma is imposed upon a party. Damage to an individual's "reputation alone . . . is [n]either 'liberty' [n]or 'property' by itself sufficient to invoke the procedural protection of the Due Process Clause." *Id.* at 701. *See generally* Note, *Reputation, Stigma and Section 1983: The Lessons of* Paul v. Davis, 30 Stan. L. Rev. 191 (1977). The most recent case from the District of Columbia Circuit, Investors Research Corp. v. SEC, 628 F.2d 168 (D.C. Cir.), *cert. denied*, 101 S. Ct. 317 (1980), implies that the factors of stigma and deprivation of livelihood, although somewhat interrelated, can be independent grounds for imposing an intermediate burden of proof. *Id.* at 175 n.41.

56. "[R]eputation alone, apart from some more tangible interests such as employment," does not justify the imposition of further procedural safeguards. Paul v. Davis, 424 U.S. 693, 701 (1976); *see* Marrero v. City of Hialeah, 625 F.2d 499, 515-16 (5th Cir. 1980) (defamatory statement causing damage to the plaintiff's business goodwill and business reputation satisfied the "stigma plus" rule of Paul v. Davis, 424 U.S. 693, 701 (1976)), *cert. denied*, 49 U.S.L.W. 3617 (U.S. Feb. 2, 1981) (No. 80-786).

B. *Risk of Erroneous Deprivation*

The second prong of the balancing test requires an analysis of whether the existing procedure adequately protects against erroneous deprivations of life, liberty, or property.[57] The probable effect of any additional procedural protections in preventing such erroneous deprivations must also be examined. The risk of erroneous deprivation under the present system is substantial because the preponderance burden of proof, perhaps the lowest possible standard, allows the highest risk of error.[58] In *Steadman v. SEC*,[59] however, the Fifth Circuit concluded that an individual's interests are adequately protected by a preponderance standard because the decision in the disciplinary hearing is subject to judicial review.[60] This reasoning is unpersuasive for two reasons. First, burdens of proof govern findings of fact.[61] When a court reviews the actions of an administrative agency, however, it normally scrutinizes only the conclusions that have been drawn from the factual findings.[62] Thus, appellate review cannot protect against erroneous findings of fact. Second, the very purpose of imposing additional procedural safeguards is to grant uniform protection, rather than ad hoc review.[63] If the Fifth Circuit's rationale were carried to its logical conclusion, applying procedural due process safeguards to any proceeding that is subject to judicial review would be precluded.

Clearly, raising the burden of proof will decrease the risk of erroneous deprivation because the theory underlying burdens of proof indicates that as the standard rises, the risk of an innocent party being found guilty decreases.[64] Moreover, the Supreme Court has stated that

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57. Mathews v. Eldridge, 424 U.S. 319, 345-47 (1976).

58. *See* notes 7, 9-12 *supra* and accompanying text.

59. 603 F.2d 1126 (5th Cir. 1979), *cert. granted*, 100 S. Ct. 1849 (1980) (No. 79-1266).

60. *Id.* at 1139.

61. Addington v. Texas, 441 U.S. 418, 423, 427 (1979); *In re* Winship, 397 U.S. 358, 370 (1970) (Harlan, J., concurring).

62. Butz v. Glover Livestock Comm'n, 441 U.S. 182, 189 (1973); Universal Camera Corp. v. NLRB, 340 U.S. 474, 488 (1951); Jacob Siegel Co. v. FTC, 327 U.S. 608, 612 (1946); Consolidated Edison Co. v. NLRB, 305 U.S. 197, 299 (1938); Strachan Shipping Co. v. Shea, 276 F. Supp. 610, 612 (S.D. Tex. 1967), *aff'd per curiam*, 406 F.2d 521 (5th Cir.), *cert denied*, 395 U.S. 921 (1969).

63. *See* La Blatt v. Twomey, 513 F.2d 641, 648-49 (7th Cir. 1975); United States v. Morse, 491 F.2d 149, 156 (1st Cir. 1974); Karr v. Schmidt, 460 F.2d 609, 615 (5th Cir.), *cert. denied*, 409 U.S. 989 (1972); *cf.* Montana v. United States, 440 U.S. 147, 153-54 (1979) (collateral estoppel "fosters reliance on judicial action by minimizing the possibility of inconsistent decisions"); Mullaney v. Wilbur, 421 U.S. 684, 697 n.23 (1975) (raising the burden of proof sets a uniform limitation on sentencing bodies).

64. *See* notes 7, 9-12 *supra* and accompanying text.

> even if the particular standard-of-proof catchwords do not always make a great difference in a particular case, adopting a 'standard of proof is more than an empty semantic exercise.' In cases involving individual rights, whether criminal or civil, '[t]he standard of proof . . . reflects the value society places on individual liberty.'[65]

Utilizing the clear and convincing standard will make the factfinder and the SEC enforcement division more aware of the significant liberty interests at stake in the disciplinary hearing.[66] Consequently, the risk of erroneous deprivation will decrease, and an individual's right to pursue a livelihood and to protect his interest in his reputation will be safeguarded.

II. The Governmental Interest

The third prong of the balancing test requires analysis of the governmental interest in the continued use of the present procedure, and the resultant burden accompanying the imposition of additional safeguards.[67] This analysis involves an examination of the effect of additional procedures on the ability of the particular governmental agency to pursue its statutory goals.[68] It also focuses upon the added governmental expense that would be incurred as a result of the imposition of greater procedural safeguards.[69]

Initially, it should be noted that the weight accorded the governmental interest in a procedure is affected by whether the procedure has been established as a matter of administrative policy or has been specifically mandated by legislative action. The presence of ex-

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65. Addington v. Texas, 441 U.S. 418, 425 (1979) (quoting Tippett v. Maryland, 436 F.2d 1153, 1166 (4th Cir. 1971) (Sobeloff, J., concurring in part, dissenting in part), *cert. dismissed*, 407 U.S. 355 (1972)).

66. *See* Addington v. Texas, 441 U.S. 418, 423-25 (1979); *In re* Winship, 397 U.S. 358, 370 (1970). In determining the burden of proof the Court has focused upon the effects of the various standards in enhancing the relative fairness of the proceeding. *See* note 57 *supra*. The initial decision of the prosecuting party to bring an action is also affected because of the symbolic and practical effects of higher burdens of proof. Prosecutors faced with higher burdens of proof may refrain from bringing suits that they might have brought under a lower burden. *See* Brief for Appellee at 23, Steadman v. SEC, No. 79-1266 (U.S., filed Feb. 15, 1980). Additionally, the SEC has contended that although lay juries may not be sufficiently aware of the potential effects of SEC sanctions and may need to have this prospect imposed upon them through a higher burden of proof, this is not true of administrative factfinders who are trained experts. Brief for Appellee at 22 n.21, Steadman v. SEC, No. 79-1266 (U.S., filed Feb. 15, 1980). Administrative experts, however, also need instruction concerning the basic guidelines as to the acceptable degree of persuasion. *See* McBaine, *supra* note 7, at 244.

67. Mathews v. Eldridge, 424 U.S. 319, 347, 349 (1976).

68. *Id.* at 347-48.

69. *Id.* at 347.

plicit legislative action indicates a more compelling governmental interest.[70] A firm congressional decision merits such deference because, as a practical matter, Congress is better able to weigh the competing interests by holding hearings, debates, and commissioning research projects.[71]

The SEC contends that section 7(c) of the Administrative Procedure Act of 1946 (APA)[72] establishes a burden of proof for its administrative proceedings.[73] Section 7(c) provides that "[a] sanction may not be imposed . . . except on consideration of the whole record . . . and supported by and in accordance with . . . reliable, probative, and substantial evidence."[74] Relying on the phrase "reliable, probative, and substantial evidence," in conjunction with the reference to the term "burden of proof" in both the text and title of section 7(c),[75] the SEC

70. *See* Vance v. Terrazas, 444 U.S. 252, 266-67 (1980); Mathews v. Eldridge, 424 U.S. 319, 349 (1976). The weight given to the governmental interest logically turns on the degree to which the legislature has discussed the issue and the detail employed in the drafting of the statute.

71. M. Jewell & S. Patterson, The Legislative Process In The United States 416-41 (3d ed. 1977); M. McGeary, The Development of Congressional Investigative Power 7-48 (1940).

72. The Administrative Procedure Act of 1946, 5 U S.C. §§ 551-59, 701-06, 1305, 3105, 3344, 5362, 7521 (1976), was enacted in response to a fear that administrative agencies were becoming an uncontrollable fourth branch of the government. *See Hearings on Federal Administrative Procedure Before the House Comm. of the Judiciary*, 79th Cong., 1st Sess. 4-5 (1945) (statement of David A. Simmons) [hereinafter cited as *House Hearings*], *reprinted in* Legislative History of the Administrative Procedure Act of 1946, 79th Cong., 2d Sess., at 48-49 (1946) [hereinafter cited as APA Legislative History]. The APA establishes minimum procedural requirements for agencies to follow. Administrative Procedure Act of 1946, § 3, 5 U.S.C. § 552 (1976); *see* H.R. Rep. No. 1980, 79th Cong., 2d Sess. 16-17 (1946) [hereinafter cited as House Report], *reprinted in* APA Legislative History, *supra*, at 250. This statute mandated greater public disclosure of agency operations and codified judicial review of agency actions and notice and hearing requirements for agency rulemaking and adjudications. *See* S. Rep. No. 752, 79th Cong., 1st Sess. 4, 8-10 (1945) [hereinafter cited as Senate Report], *reprinted in* APA Legislative History, *supra*, at 189, 193-95; K. Davis, Administrative Law Text § 1.04, at 8-9 (3d ed. 1972). For a general history of the development of the APA, see U. Lavery, Federal Administrative Law §§ 1-13 (1952). *See generally* G. Warren, The Federal Administrative Procedure Act and the Administrative Agencies (1947).

73. *See In re* M.V. Gray Invs., Inc., 44 S.E.C. 567, 575 (1971); *In re* Pollisky, 43 S.E.C. 458, 459-60 (1967). There are numerous examples of APA requirements being applied to SEC disciplinary proceedings. *See, e.g.*, Arthur Lipper Corp. v. SEC, 547 F.2d 171, 183-84 (2d Cir. 1976) (judicial review), *cert. denied*, 434 U.S. 1009 (1978); Shuck v. SEC, 264 F.2d 358, 360 (D.C. Cir. 1958) (notice and hearings). *See also* Securities Investor Protection Act of 1970, § 7(a), 15 U.S.C. § 78ggg(a) (1976) (expressly applying certain APA provisions to SEC operations).

74. Administrative Procedure Act of 1946, § 7(c), 5 U.S.C. 556(d) (1976).

75. Section 7(c) of the Administrative Procedure Act of 1946, 5 U.S.C. § 556 (1976), is entitled *"Hearings: presiding employees; powers and duties; burden of proof; evidence; record as a basis of decision."* The text of this section states in part that "[e]xcept as otherwise provided by statute, the proponent of a rule or order has the burden of proof." *Id.*, 5 U.S.C. § 556(d) (1976).

has concluded that a preponderance of the evidence standard has been mandated by Congress.[76] This assertion, however, is unfounded. The weight of the legislative history, as well as the majority of the cases dealing with this issue,[77] indicates that Congress intended to impress upon the administrative agencies the expanded role of judicial review under the APA[78] and to formulate a standard measuring the quality of the evidence,[79] not a burden of proof. Moreover,

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76. *E.g.*, *In re* M.V. Gray Invs., Inc., 44 S.E.C. 567, 567-75 (1971); *In re* Pollisky, 43 S.E.C. 458, 459-60 (1967). In *Pollisky*, the SEC, relying on Justice Clark's dissent in Woodby v. Immigration and Naturalization Serv., 385 U.S. 276 (1966), concluded that the term " 'reliable, probative, and substantial evidence' " contained in the text of the statute signalled an intent to impose a preponderance burden of proof. 43 S.E.C. at 459-60. In *Woodby*, Justice Clark had argued that this phrase, contained in the Immigration and Nationality Act of 1952, §§ 106(a)(4), 242(b)(4), 8 U.S.C. §§ 1105a(a)(4), 1252(b)(4) (1976), set a preponderance standard. 385 U.S. at 288 n.1 (Clark, J., dissenting).

77. *Compare In re* M.V. Gray Invs., Inc., 44 S.E.C. 567, 575 (1971) (the APA established a preponderance standard) *and In re* Pollisky, 43 S.E.C. 458, 459-60 (1967) (same) *with* Woodby v. Immigration and Naturalization Serv., 385 U.S. 276, 283 (1966) ("reasonable, substantial, and probative evidence" denotes a quality of evidence standard) *and* Newport News Shipbuilding & Dry Dock Co. v. Director, 583 F.2d 1273, 1278-79 (4th Cir. 1978) (less than a preponderance standard established), *cert. denied*, 440 U.S. 915 (1979) *and* Strachan Shipping Co. v. Shea, 276 F. Supp. 610, 612-13 (S.D. Tex. 1967) (APA sets less than a preponderance standard), *aff'd per curiam*, 406 F.2d 521 (5th Cir.), *cert. denied*, 395 U.S. 921 (1969).

78. Congress was cognizant that the word "substantial" did not constitute a burden of proof standard because it explicitly referred to Consolidated Edison Co. v. NLRB, 305 U.S. 197, 229-30 (1938), which squarely held that references to "substantial" established a scope of review standard. *See* House Report, *supra* note 72, at 37, *reprinted in* APA Legislative History, *supra* note 72, at 271, 92 Cong. Rec. 5653 (1946), *reprinted in* APA Legislative History, *supra* note 72, at 365 (statement of Rep. Walter). The original draft of the APA did not contain the word "substantial." The draft was subsequently amended to increase the similarity between § 7(c) and § 10 and to increase administrative awareness of judicial review. House Report, *supra* note 72, at 53 nn.16-18, *reprinted in* APA Legislative History, *supra* note 72, at 287 nn. 16-18.

79. "The second and primary sentence [which in the Senate draft contained the phrase 'relevant, reliable, and probative evidence'] of the subsection is framed on the theory that an administrative hearing is to be compared with an equity proceeding in the courts. The mere admission of evidence is not to be taken as prejudicial error (there being no lay jury to be protected from improper influence) although irrelevant and unduly repetitious evidence is to be excluded as a matter of efficiency and good practice; and no finding or conclusion may be entered except upon evidence which is plainly of the requisite materiality and competence; that is, 'relevant, reliable, and probative evidence.' Thus while the exclusionary 'rules of evidence' do not apply except as the agency may as a matter of good practice simplify the hearing and record by excluding obviously improper or unnecessary evidence, the standards and principles of probity and reliability of evidence must be the same as those prevailing in courts of law or equity in nonadministrative cases." Senate Report, *supra* note 72, at 23, *reprinted in* APA Legislative History, *supra* note 72, at 208; *see id.* at 39, 43, *reprinted in* APA Legislative History, *supra* note 72, at 228 (Appendix to the Attorney General's Statement regarding the APA); Attorney General's Manual on the

such an assertion is undercut by the SEC's recent opposition to two regulatory reform bills before Congress because they did not contain provisions that set a preponderance burden of proof for disciplinary proceedings.[80] Consequently, it is tenuous to assert that the preponderance of the evidence standard in SEC disciplinary hearings reflects more than an administrative policy determination.

Regardless of the origins of the use of the preponderance standard in SEC disciplinary hearings, however, the burden accompanying the imposition of the additional safeguard must also be examined.[81] The SEC has argued that its choice of a particular burden of proof represents an exercise of its rulemaking power,[82] and that any judicial determination of such a standard would impermissibly infringe upon that power.[83] The SEC has based this argument on the Supreme Court's decision in *Vermont Yankee Nuclear Power Corp. v. Natural Reources Defense Council, Inc.*,[84] which held that only "constitutional constraints or extremely compelling circumstances" justifies the imposition of additional procedural safeguards that affect an agency's rulemaking power.[85] The potential deprivations of liberty and property inherent in a SEC disciplinary hearing, however, form the basis

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Administrative Procedure Act 75-80 (1973). The interpretation of the APA by the attorney general, who is responsible for enforcing the Act, is particularly relevant because "a contemporaneous construction of a statute by the officer charged with its enforcement is entitled to great weight." United States v. Zucca, 351 U.S. 91, 96 (1956); *cf.* Woodby v. Immigration and Naturalization Serv., 385 U.S. 276, 283 (1966) (interpreting the phrase "reasonable, substantial and probative" as setting a quality standard of evidence).

80. *Regulatory Reform Legislation: Hearings on S.262, S.755, S.445, S.93 Before the Senate Comm. on Governmental Affairs*, 96 Cong., 1st Sess. 1325 (1979) (memorandum of the SEC). Congress did not adopt the SEC's proposal.

81. Addington v. Texas, 441 U.S. 418, 428-29 (1979); Dixon v. Love, 431 U.S. 105, 112-15 (1977); Mathews v. Eldridge, 424 U.S. 319, 335 (1976).

82. Brief for Appellee at 46-49, Steadman v. SEC, No. 79-1266 (U.S., filed Feb. 15, 1980). Rulemaking involves the setting of policy goals by an agency, as opposed to adjudicative actions, which involve an agency determination of facts. *See* K. Davis, *supra* note 72, § 5.01. Burdens of proof are procedural in nature and fall within the scope of rulemaking as defined by the Administrative Procedure Act of 1946, § 4(a), 5 U.S.C. § 553(b)(A) (1976). *But see* United States v. Florida East Coast Ry., 410 U.S. 224, 251-55 (1973) (Douglas, J., dissenting) (characterizing a ratemaking proceeding as adjudicative). *See generally* Ginnaane, *"Rule Making," "Adjudication" and Exceptions Under the Administrative Procedure Act*, 95 U. Pa. L. Rev. 621 (1947); Netterville, *The Administrative Procedure Act: A Study in Interpretation*, 20 Geo. Wash. L. Rev. 1 (1951).

83. Brief for Appellee at 46-49, Steadman v. SEC, No. 79-1266 (U.S., filed Feb. 15, 1980).

84. 435 U.S. 519 (1978). For a discussion of the effects of *Vermont Yankee*, see 1 K. Davis, Administrative Law Treatise §§ 6:35-37 (2d ed. 1978); Byse, Vermont Yankee *and the Evolution of Administrative Procedure: A Somewhat Different View*, 91 Harv. L. Rev. 1823 (1978); Stewart, Vermont Yankee *and the Evolution of Administrative Procedure*, 91 Harv. L. Rev. 1805 (1978).

85. 435 U.S. at 543 (1978); *see* Natural Resources Defense Council, Inc. v. SEC, 606 F.2d 1031, 1048 (D.C. Cir. 1979).

for "constitutional constraints or compelling circumstances" that would allow a court to raise the burden of proof.[86] Moreover, the Court has noted that the imposition of a higher burden of proof does not invade the "traditional discretion [of a sanctioning] bod[y]"[87] because the facts have been determined under a constitutionally accepted burden of proof and the agency will be free to decide which sanction to adopt.[88]

The SEC has also contended that a higher burden of proof will prevent the agency from enforcing the Securities Acts effectively.[89] It has argued that it "would not be likely to expend its limited resources in initiating meritorious cases in which it was possible clear and convincing evidence would not be available. And, in those cases that were brought, the Commission would be forced to withhold sanctions needed to protect investors."[90] Such a result, however, is unlikely. The SEC presently conducts a full investigation before it decides to bring any kind of enforcement action.[91] Thus, the decision to pursue severe sanctions through a disciplinary proceeding is made after the agency has commited its resources. Moreover, the added procedural protection of a clear and convincing burden of proof will not result in a greater financial burden on the SEC. Changing the burden of proof, unlike the addition of other procedures such as notice and a hearing, does not alter the physical or financial requirements of the proceeding.[92] Rather, it affects the mental processes of the factfinder by establishing a subjective level of persuasion that must be reached before finding that a violation has occurred.[93]

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86. *See* Swinomish Tribal Community v. Federal Energy Regulatory Comm'n, 627 F.2d 499, 510 (D.C. Cir. 1980); Association of Nat'l Advertisers, Inc. v. FTC, 617 F.2d 611, 619 n.10 (D.C. Cir. 1979); National Indus. Sand Ass'n v. Marshall, 601 F.2d 689, 699 n.35 (3d Cir. 1979); note 35 *supra* and accompanying text.

87. Mullaney v. Wilbur, 421 U.S. 684, 697 n.23 (1975).

88. *Id.*

89. Brief for Appellee at 23, Steadman v. SEC, No. 79-1266 (U.S., filed Feb. 15, 1980).

90. *Id.*

91. Enforcement Report, *supra* note 54, at 28, *reprinted in* Enforcement and Litigation, *supra* note 54, at 312; *see* S. Jaffe, *supra* note 4, § 4.02; 3 L. Loss, *supra* note 8, at 1946. *See generally* E. Brodsky, Guide to Securities Litigation 3-27 (1974).

92. The costs in time and money are minimal because additional personnel are not required to implement a higher standard and the additional time spent by the factfinder to evaluate the evidence is difficult to measure. Other procedural due process protections such as notice, hearing, limited right to assistance of counsel, and opportunity to cross examine adverse witnesses have already been made mandatory in SEC disciplinary proceedings without hindering the SEC's performance of its functions. *E.g.*, Shuck v. SEC, 264 F.2d 358, 360 (D.C. Cir. 1958) (written notice required in license revocation proceedings); Securities Exchange Act of 1934, § 15(b)(4), 15 U.S.C. 78o(b)(4) (1976) (notice and hearing); Investment Company Act of 1940, § 9(b), 15 U.S.C. § 80a-9(b) (1976) (same); 17 C.F.R. § 201.21 (1980) (oral argument); *see* S. Jaffe, *supra* note 4, § 4.02.

93. *See* notes 7, 9-12 *supra* and accompanying text.

The clear and convincing standard is a feasible burden of proof to apply in disciplinary proceedings. It has been applied in the District of Columbia Circuit for approximately three years.[94] During this time, the SEC has frequently met this higher standard in proving violations of the Securities Acts.[95] This intermediate standard also has been used successfully in common law fraud cases for over one hundred years.[96] Theoretically, the imposition of a higher burden of proof may make it more difficult for the SEC to impose severe sanctions. Nevertheless, such a possibility does not militate against mandating a standard that will more accurately reflect the individual interests at stake in a disciplinary hearing.

CONCLUSION

"In situations when individuals stand to suffer serious liabilities as a consequence of administrative action, justice may be served by demanding increased procedural protections."[97] Burdens of proof provide such protection by "reducing the risk of convictions resting on factual error."[98] The preponderance standard presently used in SEC disciplinary hearings does not adequately protect the individual liberties at stake. As a policy consideration, courts have focused on the hardship potentially imposed on the individual and have raised the burden of proof. Considering the other factors involved in a formal due process analysis, the balance still favors the need to protect the liberty interests of the individual.*

Gordon K. Eng

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94. *E.g.*, Whitney v. SEC, 604 F.2d 676, 680-81 (D.C. Cir. 1979); Collins Sec. Corp. v. SEC, 562 F.2d 820, 825-26 (D.C. Cir. 1977).

95. *See, e.g., In re* Capital Planning Sec. Co., Securities Exchange Act Release No. 13815 (Aug. 1, 1977); *In re* Blumenfeld, Securities Exchange Act Release No. 16437 (Dec. 19, 1979), [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,396; *In re* Mansfield, Securities Exchange Act Release No. 16330 (Nov. 8, 1979); *In re* D.M.R. Securities, Inc., Securities Exchange Act Release No. 16322 (Nov. 6, 1979); *In re* Hodgin, Securities Exchange Act Release No. 16225 (Sept. 27, 1979), [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,334.

96. *See* Townshend v. Strangroom, 31 Eng. Rep. 1076, 1078-79 (1801); Henkle v. Royal Exch. Assurance Co., 27 Eng. Rep. 1055, 1056 (1749).

97. Jaffe, *Administrative Law: Burden of Proof and Scope of Review*, 79 Harv. L. Rev. 914, 919 (1966).

98. Ivan v. New York, 407 U.S. 203, 204 (1972) (quoting *In re* Winship, 397 U.S. 358, 363-64 (1970)).

* After this Note was printed, the Supreme Court upheld the use of a preponderance of the evidence burden of proof in SEC disciplinary hearings. Steadman v. SEC, 49 U.S.L.W. 4174 (U.S. Feb. 25, 1981) (No. 79-1266). The Court based its decision on the Administrative Procedure Act of 1946, § 7(c), 5 U.S.C. § 556(d) (1976), concluding that Congress had affirmatively established a preponderance standard applicable to all administrative agencies. 49 U.S.L.W. at 4175-77. The Court, however, expressly left open the question, addressed in this Note, whether the imposition of such a standard is constitutionally acceptable. *Id.* at 4176 n.15.