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## Controlling Administrative Sanctions

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# CONTROLLING ADMINISTRATIVE SANCTIONS

*Fredrich H. Thomforde, Jr.\**

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## I. INTRODUCTION

SINCE the appearance of Professor Davis' book, *Discretionary Justice: A Preliminary Inquiry*,<sup>1</sup> a number of significant studies have considered the problem of abuse of administrative discretion in the

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1. K. DAVIS, *DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY* (1969).

area of law enforcement.<sup>2</sup> One aspect of administrative discretion that warrants closer scrutiny is the power of an agency to impose sanctions upon a regulated person found to have violated relevant standards of conduct. The importance of this power should not be underestimated. When carrying out the sanctioning function, agencies are acting not unlike criminal courts; accordingly, the sanctioning process is replete with many of the problems of criminal sentencing, including the difficult issue of treating similarly situated offenders similarly.<sup>3</sup> Solutions to these problems will not develop by discussing them in the abstract. Only after the particular processes are studied to determine how sanctions are actually selected and imposed, and an underlying body of data describing the sanctioning process is accumulated, will it be possible to consider realistic solutions to actual, as opposed to suspected, sanctioning deficiencies.

The purpose here is to discuss the possibilities for administrative, legislative, and judicial control of sanctioning discretion. Underlying the discussion is the basic premise that, although discretion to select sanctions may lead to arbitrary decisions, an alternative system that entirely eliminated discretion would result in the mere illusion of justice to the extent that mechanical rules deprived the agency of the flexibility to assess the various relevant factors that determine the appropriateness of a sanction in a particular case.<sup>4</sup> A system that

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2. See, e.g., Sofaer, *The Change-of-Status Adjudication: A Case Study of the Informal Agency Process*, 1 J. LEGAL STUDIES 349 (1972). The Administrative Conference of the United States has produced several studies on the exercise of discretion in the administrative agencies. See generally 1, 2 RECOMMENDATIONS AND REPORTS OF THE ADMINISTRATIVE CONFERENCE OF THE UNITED STATES (1968-1972) [hereinafter RECOMMENDATIONS AND REPORTS].

3. See, e.g., Frankel, *Lawlessness in Sentencing*, 41 U. CIN. L. REV. 1 (1972).

4. This is not to disparage attempts to limit and control sanctioning discretion by the formulation of guidelines that articulate factors to be considered in the selection of an appropriate sanction. Indeed, one major purpose of this article is to propose such guidelines. Further, social science research techniques may assist in eliminating the need for discretion in the sanctioning process. For example, the United States Board of Parole uses, as one part of its decision-making practice, a "salient factor score," the purpose of which is to "predict the likelihood that an inmate will succeed on parole." Project, *Parole Release Decisionmaking and the Sentencing Process*, 84 YALE L.J. 810, 824 (1975). The "salient factor score," however, does not purport to predict with certainty whether an individual inmate will succeed or fail on parole, but tends to "result in more 'correct' predictions in the aggregate . . ." *Id.* at 824 n.69. The Board's "Guidelines for Decision-making," while making use of prediction techniques, do not eliminate discretion altogether. *Id.* at 825. Thus, although statistical techniques may provide an important aid to improving sanctioning practice, it seems likely that, given the state of the art, the exercise of discretion will continue to be a necessary component of the process if we are to achieve a reasonable degree of individualization. See generally Coffee, *The Future of Sentencing Reform: Emerging Legal Issues in the Individualization of Justice*, 73 MICH. L. REV. 1362, 1405-15 (1975). It seems appropriate to formulate a rule that at least directs the decision-maker's attention to those relevant determinants of a sanction in any given case.

simplistically denies any exercise of administrative discretion in the sanctioning process in effect denies a more complete definition of justice. At the same time, however, a system that fails to provide adequate guides and controls on the exercise of discretion tolerates unwarranted departures from the ideal of a rule of law and not men.

The Securities and Exchange Commission (SEC) is among those federal agencies that possess discretionary power to impose sanctions upon regulated persons; for example, the SEC regulates the activities of broker-dealers registered with the Commission.<sup>5</sup> My study of the SEC's practice in this area has been described in an earlier article.<sup>6</sup> In general, that study concluded that certain factors describing the offense and offender tended to correlate with the severity of the sanction imposed; in particular, the study revealed a pronounced disparity in sanctions imposed on respondents affiliated with the New York Stock Exchange (NYSE) as opposed to all others. Furthermore, the study found that some factors that tended to correlate with sanction severity appeared to be used inconsistently.<sup>7</sup>

This Article will consider some of the possibilities for controlling and guiding the SEC's discretion to impose sanctions upon broker-dealers. Although it is limited to an examination of the Commission's practice and a discussion of possibilities for reform, the analysis contains obvious implications for any agency with the power to impose sanctions.<sup>8</sup>

## II. AN OVERVIEW OF BROKER-DEALER SANCTIONS

### A. Statutory Scheme

The Securities Exchange Act of 1934 requires virtually all broker-dealers to register with the SEC prior to engaging in the business of buying and selling securities for customers.<sup>9</sup> The Commission is empowered to impose sanctions upon both registered firms and persons associated with those firms. In the case of a registered firm, the Commission has the authority to censure it, place limitations on its

5. Securities Exchange Act of 1934, § 15(b)(4), 15 U.S.C.A. § 78o(b)(4) (Supp. Aug. 1975).

6. Thomforde, *Patterns of Disparity in SEC Administrative Sanctioning Practice*, 42 TENN. L. REV. 465 (1975) [hereinafter *SEC Case Study*].

7. See text at notes 19-29 *infra*.

8. One example is a parole board, especially if such a board has power to determine the duration of the indeterminate sentence. See Frankel, *supra* note 3, at 29-30.

9. Securities Exchange Act of 1934, § 15(a), 15 U.S.C.A. § 78o(a) (Supp. Aug. 1975). Although three narrow exemptions from registration are available, the nature of those exemptions is such that practically all broker-dealers are registered. See E. WEISS, *REGISTRATION AND REGULATION OF BROKERS AND DEALERS* 10 (1965).

activities, suspend it for a period not to exceed twelve months, or revoke its registration.<sup>10</sup> In the case of an individual, the Commission can censure, place limitations on, suspend, or bar a person from being associated with a broker-dealer.<sup>11</sup> In addition, the Commission can suspend or expel a broker-dealer firm from membership in any self-regulatory body registered with the Commission<sup>12</sup> and suspend or bar a person from being associated with any such member.<sup>13</sup>

Prior to imposing any or all of the above sanctions, the Commission must find both that the respondent has violated certain enumerated standards of conduct and that the imposition of the sanction is in the public interest.<sup>14</sup> In particular, before imposing a sanction, the Commission is required to make at least one of the following findings: (1) that the respondent willfully made a materially false or misleading statement or omission in any report required to be filed with the Commission, including respondent's application for registration; (2) that the respondent has been convicted of a felony or misdemeanor involving transactions in securities or like offenses; (3) that the respondent is subject to an injunction prohibiting him from engaging in the securities business or prohibiting unlawful activity in connection with the business; (4) that the respondent willfully violated any provision of the Exchange Act, the Securities Act of 1933, the Investment Company Act of 1940, or the Investment Advisors Act of 1940, or any rule or regulation promulgated under those acts; or (5) that the respondent willfully aided, abetted, or procured the violation of the above mentioned acts, or failed reasonably to supervise the business with a view to preventing violations of the securities laws.<sup>15</sup>

Once it makes the requisite finding of misconduct, the Commission can exercise its discretion in imposing a sanction.<sup>16</sup> The only

10. Securities Exchange Act of 1934, § 15(b)(4), 15 U.S.C.A. § 78o(b)(4) (Supp. Aug. 1975).

11. Securities Exchange Act of 1934, § 15(b)(6), 15 U.S.C.A. § 78o(b)(6) (Supp. Aug. 1975).

12. Securities Exchange Act of 1934, § 19(h)(2), 15 U.S.C.A. § 78s(h)(2) (Supp. Aug. 1975). Self-regulatory bodies include associations of brokers and dealers registered under section 15A(b), 15 U.S.C.A. § 78o-3(b) (Supp. Aug. 1975), clearing agencies registered under section 17A(b)(1), 15 U.S.C.A. § 78q-1(b)(1) (Supp. Aug. 1975), and securities exchanges registered under section 6(a), 15 U.S.C.A. § 78f(a) (Supp. Aug. 1975).

13. Securities Exchange Act of 1934, § 19(h)(3), 15 U.S.C.A. § 78s(h)(3) (Supp. Aug. 1975).

14. Securities Exchange Act of 1934, § 15(b)(4), 15 U.S.C.A. § 78o(b)(4) (Supp. Aug. 1975).

15. Securities Exchange Act of 1934, §§ 15(b)(4)(A)-(E), 15 U.S.C.A. §§ 78o(b)(4)(A)-(E) (Supp. Aug. 1975).

16. For instance, the Commission may choose to revoke the registration pursuant

express statutory limit on the Commission's exercise of discretion is the requirement that the Commission find that the sanction is in the public interest.<sup>17</sup> Although the existence of the public interest standard implies that there are some limits to the SEC's exercise of discretion, the broad range of possible interpretations of this standard<sup>18</sup> creates the potential for inequities in the sanctioning process. An analysis of the exercise of discretion by the SEC is ultimately an analysis of how, in practice, the SEC has defined the public interest.

### B. Summary of the Case Study of SEC Sanctioning Practice

The case study of SEC sanctioning practice analyzed 344 cases involving broker-dealers and persons associated with broker-dealers who were found by the Commission to have violated the securities acts.<sup>19</sup> The study attempted to answer three related questions about SEC sanctioning practice: first, which factors describing the offense and the offender are utilized by the Commission in selecting sanctions; second, does the Commission's over-all use of these factors, or combinations of factors, tend to correlate with sanction severity; and, third, do the factors, or combinations of factors, appear to be utilized in a consistent manner—that is to say, do like cases tend to receive like sanctions.<sup>20</sup>

To answer these questions, each case was first analyzed with reference to specific factors describing both the offender and the offense involved. Factors describing an individual respondent characterized either his status or his attitude. Factors relating to the respondent's status included age, experience, prior record, and general reputation and current status in the industry; those relating to the respondent's attitude included intent, willingness to reform, willingness to make restitution, and willingness to consent to the imposition

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to section 15(b)(4), and expel the respondent from the National Association of Securities Dealers pursuant to section 19(h)(2).

17. Section 19(h) has an additional general requirement that action taken by the Commission be "for the protection of investors, or otherwise in furtherance of the purposes of" the Act. Securities Exchange Act of 1934, §§ 19(h)(1), (2), (3), 15 U.S.C.A. §§ 78s(h)(1), (2), (3) (Supp. Aug. 1975).

18. For instance, the SEC has occasionally found that the imposition of a sanction for a willful violation is not required to protect the public interest. *See, e.g.*, David G. Baird, 43 S.E.C. 815 (1968).

19. As used herein, "case" refers to each individual respondent, even though more than one respondent may have been a party to the same action.

20. As used herein, a "standard" is the criterion or rule; it measures and announces the legal significance of a particular factor or combination of factors. A "factor" is an element or characteristic of the offense or offender that may be referred to or embodied in a standard.

of a sanction. Factors describing the offense included not only the particular statutory section or rule violated, but also the geographic scope of the violation and the amount of money and the number of investors involved.

It was possible, therefore, not only to determine which factors appeared in the cases, and with what frequency,<sup>21</sup> but also to determine whether a correlation existed between certain factors and sanction severity. In general, the study indicated that the presence of certain factors tended to affect the severity of the sanction imposed in a manner that was both predictable and consistent with stated Commission policy.<sup>22</sup> Thus, although 37.8 per cent of all cases resulted in expulsion, the expulsion rate increased if the offense involved fraud (42.1 per cent) or an intentional violation of the law (53.2 per cent), or if the respondent either had a prior record (66.7 per cent) or contested the Commission's action (62.1 per cent). On the other hand, the expulsion rate dropped in those cases in which the offense did not involve fraud (21.1 per cent), or in which the respondent offered to make restitution (20 per cent), had a good reputation (17.9 per cent), consented to the imposition of a sanction (25.5 per cent), or was willing to reform (3.7 per cent).<sup>23</sup>

Despite the obvious impact of certain factors, the study revealed that no single factor was controlling. The lack of a controlling factor is not particularly surprising given the variety of possible combinations in which factors (both mitigating and aggravating) may appear. However, even when apparently similar cases were compared, not all respondents received the same sanction. Further, the study revealed that some factors were not always utilized by the Commission even though they were discoverable and their relevance had been acknowledged by the SEC in other cases. For example, although the respondent's reputation in the industry was acknowledged as a relevant consideration in over 12 per cent of the cases (the presence of a good reputation correlating with a reduction in expulsion rate), the reputation of respondents in the other 88 per cent of the cases apparently was not considered in selecting an appropriate sanction.<sup>24</sup> It is possible of course that the Commission did consider reputation in all cases, but simply failed to mention that it had been considered. It is

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21. See *SEC Case Study*, *supra* note 6, at 493 (Table R) (summarizing frequency with which factors appeared).

22. For a discussion of SEC sanctioning policy to protect investors, deter violations, achieve voluntary compliance, and rehabilitate respondents, see text at notes 46-78 *infra*.

23. See *SEC Case Study*, *supra* note 6, at 493 (Table R), 476-97.

24. See *id.* at 490-91 (Table P), 493 (Table R).

also possible, however, that the factor was overlooked or ignored in some cases.<sup>25</sup> Thus, although the study showed that the presence of certain factors tended to correlate with sanction severity, it also raised the possibility that the factors utilized by the Commission in determining an appropriate sanction were not applied consistently.

Finally, the data revealed what appears to be a substantial disparity between the severity of sanctions imposed upon respondents affiliated with the NYSE and sanctions imposed upon all others. Table A summarizes the analysis by comparing the rates of expulsion for NYSE respondents with the rates for all other respondents in fraud and nonfraud cases.<sup>26</sup>

TABLE A  
Comparison of Expulsion Rates for NYSE  
Respondents and All Others

	NYSE	N.Y. (other than NYSE)	Non-N.Y. (other than NYSE)
Fraud			
Rate of Ex- pulsion	13.5% (10 of 74)	24.5% (14 of 57)	64.2% (88 of 137)
Nonfraud			
Rate of Ex- pulsion	4% ( 1 of 25)	28.6% ( 4 of 14)	31.3% (10 of 32)
Rate of Censure	48% (12 of 25)	28.5% ( 4 of 14)	12.5% ( 4 of 32)

The disparity in sanction severity is most pronounced when the rates of expulsion for NYSE and non-New York fraud are compared;<sup>27</sup> however, the disparity also exists in the smaller category of

25. Although reputation was noted in only 12 per cent of the cases, it is obvious that all respondents have some kind of reputation. This is not to suggest that reputation will always be relevant. It is to say, however, that, when a discoverable factor is not specifically considered, one possible conclusion is that it was overlooked in some cases in which it might have been relevant.

26. These findings are discussed in detail in *SEC Case Study*, *supra* note 6, at 497-515.

27. Even the 13.5 per cent figure is misleadingly high. Only one firm, Pickard & Co., had its registration revoked; the firm and its employees who were barred account for over 40 per cent of all NYSE bars and revocations. See C. Eugene Osment, II, SEC Exchange Act Release No. 8658 (July 25, 1969); Joseph V. Shields, Jr., SEC Exchange Act Release No. 8484 (Jan. 3, 1969), [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,643; Jack Flittman, SEC Exchange Act Release No. 8449 (Nov. 4, 1968); John W. Bendall, Jr., SEC Exchange Act Release No. 8448 (Nov. 14, 1968); Pickard & Co., SEC Exchange Act Release No. 8447 (Nov. 14, 1968);



nonfraud.<sup>28</sup> In general, the study concluded that New Yorkers (particularly in fraud cases) tend to be less likely to be expelled than non-New Yorkers, and NYSE respondents, regardless of their location, are the least likely of all to be expelled in either fraud or nonfraud cases. As described in more detail in the case study, this disparity was not explained by taking into account more particular descriptions of the offense and offender.<sup>29</sup>

The case study of SEC practice thus presents two problems: first, the possibility that in exercising its discretion to sanction offenders the SEC is utilizing relevant factors in an inconsistent manner; and, second, that SEC sanctioning practice has resulted in a disparity between the treatment of NYSE and non-NYSE respondents. The question, then, is whether these kinds of problems lend themselves to correction by administrative, legislative, or judicial action.

### III. CONTROL OF DISCRETION BY LEGISLATIVE OR ADMINISTRATIVE RULES

#### A. *The Necessity, Desirability, and Practicability of Rules To Limit Discretion*

The use of discretion<sup>30</sup> in the sanctioning process is as essential as the abuse of discretion is intolerable: Because rules cannot be formulated to deal with every combination of factors that may confront a decision-maker, some discretion is necessary to make the punishment fit the crime; at the same time, unlimited discretion may lead to a situation in which sanctions are imposed without standards, without certainty, and without an even hand.<sup>31</sup> To a great extent, the process of administrative sanctioning (and the process of sentencing in general) has been allowed to proceed free from rules and standards that would define the boundaries of the exercise of discretion. At the outset, then, any attempt to formulate a rule purporting to limit sanctioning discretion ought to consider three broad questions: Is rule-making in this area (1) necessary, (2) desirable, or (3) practicable?<sup>32</sup>

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John Sackville-Pickard, SEC Exchange Act Release No. 8433 (Oct. 24, 1968), [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,620.

28. Moreover, in nonfraud cases NYSE respondents had a significantly higher frequency of censure. See Table A.

29. See *SEC Case Study*, *supra* note 6, at 501-15.

30. "Discretion" is used herein as defined by Davis: "A public officer has discretion whenever the effective limits on his power leave him free to make a choice among possible courses of action or inaction." K. DAVIS, *supra* note 1, at 4.

31. See Frankel, *supra* note 3, at 1-5.

32. These three questions are implicit in Professor Sofaer's "Framework for Governing Discretion," described in Sofaer, *Judicial Control of Informal Discretionary Adjudication and Enforcement*, 72 COLUM. L. REV. 1293, 1295-98 (1972).

It has been suggested that the subject of administrative discretion is deserving of judicial attention "only when the [exercise of discretion] may have serious consequences."<sup>33</sup> This generalization provides an appropriate starting point for questioning the necessity of rule-making in the area of sanctioning discretion. It would seem obvious that the manner in which the SEC exercises its power to choose an appropriate sanction has "serious consequences" for the respondent since, among other things, the respondent may lose the right to engage in the securities business.<sup>34</sup>

Yet, even if the exercise of Commission discretion may have serious consequences, the necessity for rule-making diminishes if the discretion is already "effectively governed by standards, rules or other guides that narrow discretion."<sup>35</sup> Although SEC sanctioning practice is limited to some extent by existing standards, these standards only minimally restrict the exercise of discretion. For example, the statutory "protection of investors" and "public interest" standards act as general guidelines for the exercise of sanctioning discretion. However, these general guidelines will be of little help to regulated parties in determining either what the law is or how it will be applied in a particular case. Similarly, the SEC currently relies on certain factors that describe the offense and offender in determining an appropriate sanction, yet the case study shows that the Commission utilizes those factors in an inconsistent manner. Thus, even if appropriate standards for the exercise of Commission discretion presently exist, rule-making might contribute to a more effective utilization and application of those standards.

If there is a general necessity to provide more effective guidelines for the sanctioning practice, one may still question the desirability of attempting to limit discretion by rule-making. In particular, one may ask whether rules that purport to provide standards to limit discretion deprive administrators of the flexibility necessary to adapt to unanticipated circumstances or to achieve individualized justice.<sup>36</sup> On one level, of course, the question goes to the matter of draftsmanship. A poorly drafted rule might not only deprive the adjudicator of flexibility, but might also "require" sanctions that would be as unjust as those imposed under a system of standardless sanctioning. Beyond the problem of adequate draftsmanship, the question focuses on the

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33. *Id.* at 1296.

34. Not only expulsion, but suspension as well, may prove economically disastrous for a small firm. See SEC, REPORT OF THE ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES 45 (1972) [hereinafter ADVISORY COMMITTEE REPORT].

35. Sofaer, *supra* note 32, at 1296.

36. *Id.* at 1296-97.

tension between the goals of consistency and flexibility in law enforcement. To recognize this tension, however, is not to require a choice between goals, for the principles of flexibility and consistency are ultimately compatible.

It has been suggested that consistency is not a primary requirement of law enforcement and that, in the particular context of sanctioning, there is no legal necessity that similar cases be treated similarly.<sup>37</sup> If taken literally, however, such a position runs counter to the principle of equal justice by the rule of law—a principle that is rooted in the Constitution. Moreover, what may appear to be comparable cases are often not comparable at all. For example, suppose that two broker-dealers each sold securities by means of a misleading prospectus. One, an experienced salesman with a prior record, may have known that portions of the prospectus were false; the other, an inexperienced person, may only have been negligent in not discovering the truth. Accordingly, if experience, state of mind, or prior offenses are relevant considerations in determining an appropriate sanction, the two cases are not “alike.” Once genuinely similar cases are identified, the principle of consistency becomes far more compelling.

The principle of flexibility becomes important in the identification process. Flexibility is not a license to ignore relevant factors; rather, it permits the adjudicator to take into account those factors that determine like cases. Thus, a rule that articulates relevant factors to guide sanctioning discretion does not necessarily interfere with the proper role of flexibility. A rule that is designed to direct the attention of the adjudicator to the generally relevant factors and to permit the adjudicator to take into account factors peculiar to a particular case furthers both the principle of consistency and the principle of flexibility.<sup>38</sup>

Another arguably undesirable effect of rules that guide discretion is that known standards eliminate the potential deterrent effect of uncertainty. Thus, for example, if a prosecutor's office is unable to prosecute all known violations, the publication of the standards it follows in selecting cases might result in encouraging violations by

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37. See, e.g., *Dlugash v. SEC*, 373 F.2d 107, 110 (2d Cir. 1967); Martin A. Fleishman, 43 S.E.C. 185, 190 (1966). Professor Norman Abrams, in an excellent treatment of prosecutorial discretion, quotes Emerson's line: “A foolish consistency is the hob-goblin of little minds, adored by little statesmen and philosophers and divines.” Abrams, *Internal Policy: Guiding the Exercise of Prosecutorial Discretion*, 19 UCLA L. REV. 1, 5 n.11 (1971). One may, however, note the distinction between *foolish* and *necessary* consistency.

38. See generally Reiss, *Research on Administrative Discretion and Justice*, 23 J. LEGAL EDUC. 69, 72-73 (1970).

those not subject to prosecution under those standards. Yet, even if under some circumstances reasons exist for not publicly disclosing factors that guide prosecutorial discretion,<sup>39</sup> the situation is different in the area of sanctioning discretion: The value of known standards that control the sanctioning process would seem to outweigh the value of any possible deterrent effect of uncertainty. After all, a rule that articulates standards to limit sanctioning discretion would not necessarily require leniency or encourage violations; rather, the effect of a properly drafted rule would be to ensure that reasonably equal sanctions were imposed upon similarly situated offenders.

Finally, if a rule limiting sanctioning discretion is both necessary and desirable, one might still question the practicability of requiring such a rule. Would the costs involved in formulating and applying such a rule outweigh its benefits?<sup>40</sup> Naturally, costs in time and manpower are incurred both in promulgating rules and in writing decisions applying such rules to a given case. Whether these costs are prohibitive, however, depends upon the existing practice of a particular agency. The costs of formulating and applying a rule to limit the sanctioning discretion of the SEC would be minimal: The Commission has the statutory authority to formulate rules in accordance with the procedures required by the Administrative Procedure Act.<sup>41</sup> The costs of administrative rule-making would seem to be balanced by the prospective savings to the Commission and regulated persons from the existence of articulated guidelines to delimit sanctioning practice. Because of the Commission's expertise in this area, SEC rule-making would also appear to be more efficient than appealing to either the courts or Congress. Perhaps more importantly, the Commission already writes opinions purporting to give reasons for imposing its sanctions; thus, a rule requiring the Commission to demonstrate that it has considered certain relevant factors would impose little additional burden upon existing adjudicative procedures. A rule aimed at controlling the exercise of discretion in this relatively formal sanctioning process would be intended to direct adjudicative efforts more profitably for the benefit of both the Commission and the regulated party.

The practicability of requiring a rule to limit sanctioning discretion must ultimately turn upon our ability to draft a rule that will offer meaningful guidance to the adjudicator. In an analogous

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39. See, e.g., Abrams, *supra* note 37, at 28-34; Sofaer, *supra* note 29, at 1297.

40. See, e.g., Sofaer, *supra* note 32, at 1296, 1298.

41. Securities Exchange Act of 1934, § 23(a), 15 U.S.C. § 78w(a) (1970). The rule-making requirements of the APA are found at 5 U.S.C. § 553 (1970).

context, Justice Harlan described the possibility of articulating meaningful standards to guide a jury in sentencing as "beyond present human ability."<sup>42</sup> Whether or not such pessimism is warranted, however, depends upon what one attempts to achieve in a rule aimed at guiding the exercise of human judgment. One could, for example, promulgate a rule that declared that any sale of securities by fraud would result in expulsion; such a rule would be easy to apply but would offend our felt need for individualized justice. On the other hand, one might endeavor to formulate a rule that defined every possible combination of factors in terms of a precise equation in an attempt to produce absolutely equal sanctions; however, here one must agree with Justice Harlan—such an attempt would be "beyond present human ability." Yet neither of these extremes is necessary. The Commission's own practice demonstrates that it is possible to articulate certain relevant factors that ought to affect sanction severity. The object of formulating a rule to require the Commission to utilize these factors more consistently in the sanctioning process would be to codify the best of SEC practice in order to bring about a more uniform application of existing standards.

Obviously, doubts about the practicability of formulating a meaningful rule that will accommodate the principles of flexibility and consistency<sup>43</sup> will not be resolved by mere generalizations. The discussion, therefore, must focus on the essential elements of a rule and culminate in a proposed rule applicable to SEC practice.

### B. *The Elements of a Rule*

The only explicit statutory standard that limits the SEC's sanctioning discretion is the requirement that any sanction imposed by the Commission be in the public interest.<sup>44</sup> This standard does not adequately guard against the abuse of discretion, nor does it effectively guide the exercise of discretion. A workable rule must provide both specific guidelines that are consistent with and supportive of the purposes of the legislation being enforced, and procedures designed to ensure that the substantive statutory provisions are followed. Thus, the first step in formulating a rule to guide SEC sanctioning discretion is to determine the purposes to be served by imposing a sanction upon a regulated party; indeed, our perception of the proper purposes of

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42. *McGautha v. California*, 402 U.S. 183, 204 (1971). See also *In re Sierant*, 24 N.Y.2d 675, 682, 249 N.E.2d 455, 458, 301 N.Y.S.2d 604, 610 (1969).

43. Professor Davis refers to this balance as "[t]he optimum breadth for discretionary power." K. DAVIS, *supra* note 1, at 52 (emphasis omitted).

44. Securities Exchange Act of 1934, § 15(b)(4), 15 U.S.C.A. § 78o(b)(4) (Supp. Aug. 1975). But see note 17 *supra*.

SEC sanctions will affect the necessity, severity, or validity of imposing a sanction in any given case.<sup>45</sup> Once the proper sanctioning purposes are discovered, the relevant factors that any rule serving these purposes must articulate can be identified, and the procedural requirements of such a rule can be developed.

### 1. *The Purpose of SEC Sanctions*

The purpose of SEC sanctions has been described as remedial rather than punitive; thus, it has been said that sanctions are intended to protect investors rather than to punish offenders.<sup>46</sup> We should, however, question whether the matter can be disposed of simply by attaching the remedial-punitive labels.<sup>47</sup> Is this distinction either meaningful or desirable? In particular, to what extent, if any, should this distinction influence the nature of a rule designed to control sanctioning discretion?

The Commission and the courts purport to be guided by the remedial-punitive distinction, as a recent Sixth Circuit case demonstrates. In *Beck v. SEC*,<sup>48</sup> the petitioner, a securities salesman, had been suspended by the Commission for four months for willfully violating the Securities Act by selling securities through the use of false and misleading statements.<sup>49</sup> Recognizing the remedial-punitive distinction, the Commission stated: "The sanctions authorized by Section 15 of the Exchange Act are part of a comprehensive regulatory scheme to protect the public interest . . . . We have been cognizant of the importance of exercising the discretionary power reposed in us in this area in a manner that will afford investor protection without visiting upon the wrongdoers adverse consequences not required in achieving statutory objectives."<sup>50</sup> Finding "that the probability of similar future occurrences is such that a temporary exclusion from the securities business is required,"<sup>51</sup> the Commission con-

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45. Judge Frankel suggests that one of the "first principles" in an attempt to reform sentencing practice should be "a statement of the substantive aims of sentencing . . . ." Frankel, *supra* note 3, at 41. His second recommended principle is "some fundamental procedural directives . . . ." *Id.* See text at notes 99-101 *infra*.

46. See E. WEISS, *supra* note 9, at 203.

47. There are, to be sure, other possible sanction purposes, including rehabilitation, voluntary compliance, and deterrence. See text at notes 72-78 *infra*.

48. 430 F.2d 673 (6th Cir. 1970). The case had been before the court once before. 413 F.2d 832 (6th Cir. 1969). At that time, the Sixth Circuit remanded the case to the Commission for a more specific statement of the reasons for suspending Beck, adding that, without an adequate statement of reasons, it could not "determine whether this sanction constitutes an abuse of discretion . . . ." 413 F.2d at 834.

49. Commonwealth Sec. Corp., 44 S.E.C. 100, at 100 (1969).

50. 44 S.E.C. at 101 (footnote omitted).

51. 44 S.E.C. at 102.

cluded that the sanction "was necessary and appropriate for the remedial purposes contemplated under the federal securities laws."<sup>52</sup> In an attempt to convince the Commission that the sanction was unnecessary, Beck pointed out that the 1961 violation occurred when he was inexperienced and inadequately trained. Subsequently, Beck continued, he had "received appropriate training from a securities firm which [had] employed him since August 1962," and, since that time and July 1968 when the Commission suspended him, "there [had] been no complaints concerning his conduct . . ."<sup>53</sup> The Commission, while agreeing that these factors were "favorable" and noting that they were considered in imposing suspension, held that "they do not assure that Beck will observe the required standard of conduct in the future . . ."<sup>54</sup> Accordingly, the SEC found that a four month suspension was necessary "to adequately [impress] upon [Beck] . . . the necessity of avoiding a repetition of his specific misconduct. . . ."<sup>55</sup> The court of appeals, however, disagreed. Noting that "the record discloses no reason to believe that [Beck] is inclined to commit any further illegal or fraudulent acts,"<sup>56</sup> the court concluded "that the Commission's order is punitive, not remedial" and that "the relationship between the remedy adopted and the stated reasons . . . is so tenuous that we deem the order a gross abuse of the Commission's remedial authority."<sup>57</sup>

*Beck* is important not only because it demonstrates commitment to the principle that SEC sanctions should have a remedial purpose, but also because it demonstrates that the characterization of a particular sanction as "punitive" rather than "remedial" may have an important effect on the validity of the Commission's action.<sup>58</sup> Is one to conclude, therefore, that whenever a sanction can be characterized as punitive, its imposition is an abuse of discretion? It is arguable that the sanctions available to the SEC—censure, suspension, and expulsion—always have a punitive effect, particularly from the point of view of the offender. *Beck* itself demonstrates how vague the distinc-

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52. 44 S.E.C. at 103.

53. 44 S.E.C. at 100-01.

54. 44 S.E.C. at 102.

55. 44 S.E.C. at 102-03.

56. 430 F.2d at 674.

57. 430 F.2d at 675. The court also noted that the six-year delay in imposing the sanction was not Beck's fault. 430 F.2d at 674. Other persons involved in the same scheme were criminally prosecuted during this time. See *United States v. Armel*, 384 F.2d 51 (6th Cir. 1967), *cert. denied*, 390 U.S. 944 (1968).

58. The case is also significant in that it represents a rare reversal of an SEC sanction. See text at notes 169-71 *infra*. The courts have usually maintained a hands-off attitude when reviewing SEC sanctions. See, e.g., *Dlugash v. SEC*, 373 F.2d 107, 110 (1967); *Tager v. SEC*, 344 F.2d 5, 8-9 (1965).

tion between punitive and remedial sanctions can be. For example, although the court in *Beck* held that SEC sanctions may not be punitive, it agreed that sanctions may be used to deter the offender from future offenses.<sup>59</sup> Yet, for what reason is an offender deterred, if not to avoid future punishment? To say that an offender will be deterred not to avoid punishment, but rather to avoid future remedial action is to create a formal distinction without substance.<sup>60</sup> Thus, if punitive effect alone invalidates a sanction, courts should feel hard-pressed to sustain any SEC sanction.<sup>61</sup>

Apparently, the punitive-remedial labels owe their continuing vitality, at least in part, to the belief that empowering a nonjudicial instrumentality with the authority to impose criminal (*i.e.*, punitive) sanctions may raise constitutional difficulties.<sup>62</sup> To be sure, administrative procedures are "incompatible with the accepted rules and constitutional guarantees of power governing the trial of criminal prosecutions."<sup>63</sup> The accepted technique used to avoid the constitutional problem has been to label administrative sanctions "remedial" in order to be "free of the punitive criminal element."<sup>64</sup> Commentators<sup>65</sup> have often noted Justice Frankfurter's apparent frustration with the "dialectical subtleties"<sup>66</sup> of the distinction. His characterization of the majority's use of the punitive-remedial rationale in *United States ex rel. Marcus v. Hess*<sup>67</sup> is illustrative of the problem: "The argument seems to run thus: Double jeopardy means attempting to punish criminally twice; this is not an attempt to punish criminally because it is a civil proceeding; it is a civil proceeding because . . . it is a 'civil sanction' . . . and the sanction is 'civil' because it is 'remedial' and not 'punitive' in nature."<sup>68</sup> Justice Frankfurter went on to suggest that "[p]unitive ends may be pursued in civil proceedings, and, conversely, the criminal process is frequently employed to attain remedial rather than punitive ends."<sup>69</sup> Justice Black's majority

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59. 430 F.2d at 674.

60. Although the court found it unnecessary to decide whether a sanction may have as one of its purposes deterring others from violations, the Commission claimed this was a proper remedial purpose. 430 F.2d at 675.

61. Reviewing courts usually simply declare that SEC sanctions are not punitive, but rather remedial. *See, e.g.*, *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940).

62. *See Helvering v. Mitchell*, 303 U.S. 391, 400 (1938); K. DAVIS, 1 ADMINISTRATIVE LAW TREATISE § 2.13 (1958); McKay, *Sanctions in Motion: The Administrative Process*, 49 IOWA L. REV. 441, 444-45 (1964).

63. *Helvering v. Mitchell*, 303 U.S. 391, 403 (1938).

64. *Helvering v. Mitchell*, 303 U.S. 391, 399 (1938).

65. *See, e.g.*, 1 K. DAVIS, *supra* note 62, § 2.13, at 135 n.12.

66. *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 554 (1943) (concurring).

67. 317 U.S. 537 (1943).

68. 317 U.S. at 553 (concurring).

69. 317 U.S. at 554.



opinion in *Hess* appears at least to have acknowledged Justice Frankfurter's objection. Justice Black pointed out that "[p]unishment, in a certain and very limited sense, may be the result of [a remedial statute] so far as the wrong-doer is concerned,' but this is not enough to label it as a criminal statute."<sup>70</sup>

It may be possible to give more substantive content to the remedial-punitive characterization if a distinction is drawn between the primary purpose of a sanction and its possible effect; indeed, Justice Black may have been alluding to this distinction when he noted in *Hess* that the fact that the enforcement of a statute may result in punishment, from the offender's standpoint, is not enough to make it a criminal statute. For example, the *Beck* decision can be interpreted as holding that the SEC's sanction was invalid not because of the presence of a punitive effect, but because of the absence of a valid remedial purpose. Since Beck committed no violation during the six-year period following his infraction, he did not appear to need suspension "to adequately [impress] upon him . . . the necessity of avoiding a repetition of his specific misconduct . . ." <sup>71</sup> Thus, the absence of factors showing that investors were in need of protection from Beck led the court to conclude that there was no remedial purpose served by suspension and that the sanction was, therefore, primarily punitive. Presumably, if the sanction had been imposed shortly after Beck's violation, the SEC might have been warranted in at least suspending Beck on the ground that there was a possibility of future violations. The primary purpose of a suspension under those circumstances would have been to protect investors by deterring Beck from future violations, even though suspension clearly would have had a punitive effect from Beck's point of view. This is not to suggest that the line between purpose and effect is always clear or easy to draw. *Beck* offers some evidence, however, that the distinction can provide a workable basis of decision for both the Commission and reviewing courts.

Finally, there are other remedial purposes that may be served by SEC sanctions, in addition to those illustrated by *Beck*. Although rehabilitation has become a significant, if not the primary, goal of the criminal sanction,<sup>72</sup> it is probably a far less significant function of the regulation of the securities market. By and large, regulatory offenders are not perceived to have social or psychological problems that have led to their offenses; furthermore, the Commission simply lacks

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70. 317 U.S. at 551, quoting *Brady v. Daly*, 175 U.S. 148, 157 (1899).

71. *Commonwealth Sec. Corp.*, 44 S.E.C. 100, 102-03 (1969).

72. See Frankel, *supra* note 3, at 29.

the necessary resources (both in terms of manpower and in terms of statutory authority) to undertake the kind of rehabilitation hoped for in the criminal sector. On the other hand, a kind of rehabilitation of offenders is attempted when the Commission (as part of its sanction) conditions re-entry into the securities business on the respondent's retraining and close supervision.<sup>73</sup> This appears to be a technique that is becoming more favored with the Commission.<sup>74</sup>

An SEC sanction may also serve the purpose of achieving voluntary compliance with the law.<sup>75</sup> The Commission's primary method of achieving voluntary compliance is probably through interpretive releases and statements of policy that inform regulated persons about the law and how it will be enforced.<sup>76</sup> Public notice of the imposition of a sanction may also contribute to voluntary compliance by serving as a deterrent to others.<sup>77</sup> Acknowledging the deterrent value of a sanction reintroduces the question of the use of sanctions as a form of punishment, for how else does a sanction deter, if not as a threat of punishment to those who would do likewise? Again, however, the question is one of ascertaining the primary purpose of a sanction, for here the purpose is not to punish, but to achieve general compliance—a valid remedial purpose.<sup>78</sup>

To summarize, it appears that an SEC administrative sanction may serve several remedial purposes that are consistent with the

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73. See, e.g., Roy V. Montgomery, SEC Exchange Act Release No. 8223 (Jan. 3, 1968).

74. This assertion is based on the author's review of all SEC administrative decisions between November 1973 and October 31, 1974. See, e.g., Reynolds & Co., SEC Exchange Act Release No. 10835 (May 31, 1974), [1973-1974 Transfer Binder] CCH FED. SEC. L. REP. ¶79,811.

75. See ADVISORY COMMITTEE REPORT, *supra* note 34, at 14.

76. Releases not only explain Commission interpretations of law and policy, but also serve as warnings to the broker-dealer community. In the midst of the 1968 back-office "crunch," for instance, the Commission issued a release to the industry warning its members that certain practices (e.g., accepting a customer's order when unable to deliver the securities) would be construed as violations of the anti-fraud provisions of the Exchange Act. SEC Exchange Act Release No. 8363 (Aug. 7, 1968), [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,583.

77. The Commission, at least, believes in the deterrent value of sanctions. See, e.g., Commonwealth Sec. Corp., 44 S.E.C. 100, 101 (1969).

78. Professor Goldschmid suggests that it would be worthwhile to study the deterrent value of administrative sanctions. See Goldschmid, *An Evaluation of the Present and Potential Use of Civil Money Penalties as a Sanction by Federal Administrative Agencies*, in 2 RECOMMENDATIONS AND REPORTS, *supra* note 2, at 896, 946.

The general deterrent value of a sanction raises a potential question of fairness to a particular offender. If, for example, the facts of a case would not otherwise warrant a severe sanction to deter a particular offender, would the Commission be justified in making an "example" of him? The Commission could conceivably justify any sanction by its deterrent effect on others. General deterrence should be a secondary reason for imposing a sanction; its use as the sole justification is questionable.

purpose of the securities acts to protect investors and ensure fair securities markets.<sup>79</sup> A rule to guide sanctioning discretion should require that the Commission support the imposition of a sanction in light of the need to protect investors, deter violations, achieve voluntary compliance with the securities laws, or contribute to the rehabilitation of offenders. Naturally, the importance of any one purpose, or combination of purposes, will depend on the particular case being adjudicated. A requirement that purposes be articulated, however, will tend to ensure (though it will not guarantee) that the SEC has, in fact, selected a sanction appropriate for the individual offender as well as one necessary to achieve the regulatory purposes of sanctioning. Indeed, the Commission generally supports its sanctions with such reasons, so the requirement should impose no new or onerous burden on the staff.<sup>80</sup> By articulating the proper purposes served by SEC sanctions, the rule would also provide a form of notice to respondents that would enable them to offer "evidence" on their behalf relevant to those purposes.<sup>81</sup> Further, such reasons, in light of the findings of fact, would provide a meaningful basis for judicial review of sanctions.

## 2. *Factors Describing the Offense and the Offender*

Formal recognition of the purposes served by sanctions provides, at best, only a general directive to guide Commission discretion. Realization of the dual sanctioning objectives of individualized justice and equal treatment of like cases depends upon the Commission's ability to describe not only the specific law violated, but also how it was violated, and by whom. Thus, over the years, the Commission has come to rely upon a series of factors that describe both the offense and the offender. The importance of these factors becomes clear when considered in light of the remedial purpose of the Exchange Act.

In determining the nature of an offense, the Commission considers not only the broad categories of fraud and nonfraud, but also the particular types of fraud and nonfraud offenses; obviously, the general goal of protecting investors requires that some types of offenses

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79. See Securities Exchange Act of 1934, § 2, 15 U.S.C.A. § 78b (Supp. Aug. 1975); §§ 19(h)(1), (2), (3), 15 U.S.C.A. §§ 78s(h)(1), (2), (3) (Supp. Aug. 1975).

80. It would, however, relieve the Commission from having to show that the sanction was not punishment.

81. The case study revealed that some factors appeared to have been overlooked in the decision process, even though the factors were discoverable. See *SEC Case Study*, *supra* note 6, at 496; note 25 & text at notes 24-25 *supra*.

be taken more seriously than others.<sup>82</sup> In addition to the type of offense committed, other factors tend to distinguish the more from the less serious offenses. One such factor is the amount of money involved. Although far from a perfect indicator, the amount of money involved may tend to help identify whether a particular offense poses a threat to investors. One finding of the case study, however, was that, though the Commission has acknowledged the importance of this factor in determining appropriate sanctions,<sup>83</sup> the amount of money involved was considered in relatively few cases.<sup>84</sup> The same observation can be made about two other factors that describe and thus distinguish offenses—the number of investors involved and the geographic scope of the violation. All else being equal, an offense that involves relatively few investors and that is limited to one transaction in one town may reasonably be viewed as a less serious threat to investors than an offense involving thousands of investors nationally. As in the case of the amount of money, however, these factors appear to have been considered in far fewer cases than may have been possible.<sup>85</sup> Since the Commission clearly recognizes the potential relevance of these factors,<sup>86</sup> a rule that seeks to limit the Commission's discretion in order to ensure more uniform consideration of relevant factors ought to include them as appropriate for the Commission's consideration.

The amount of money involved in an offense is a factor that is related to, but distinguishable from, the ultimate financial loss to investors. Although a large sum may have been involved, there may have been no resulting loss to investors; for example, a violation of the net capital rule<sup>87</sup> involves "an amount of money," but does not necessarily result in any loss to investors. Even in those cases in which the offense involves placing the investor's money in direct

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82. The case study grouped offenses in eight categories: (1) egregious fraud; (2) less egregious fraud; (3) egregious fraud and nonfraud combined; (4) less egregious fraud and nonfraud combined; (5) sale of unregistered securities; (6) back office violations; (7) nonfraud combining (5) and (6) above; and (8) failure to supervise. In general, it was found that the more serious the offense, the more severe the sanction. See *SEC Case Study*, *supra* note 6, at 477-84.

83. See, e.g., Irving Friedman, 43 S.E.C. 314, 323 n.19 (1967).

84. Only 16.6 per cent of all cases mentioned the amount of money. See *SEC Case Study*, *supra* note 6, at 482.

85. Only 5.5 per cent of the cases mentioned the number of investors involved, and only 8.4 per cent mentioned the geographic scope. See *SEC Case Study*, *supra* note 6, at 483.

86. See, e.g., Bateman Eichler, Hill Richards, Inc. SEC Exchange Act Release No. 8333 (June 14, 1968) (geographic scope); Thomas Brown, III, 43 S.E.C. 285 (1967) (number of investors).

87. 17 C.F.R. § 240.15c3-1 (1975). The rule is intended to ensure a firm's liquidity by requiring that aggregate indebtedness not exceed 2000 per cent of its net capital.

jeopardy, such as sales by fraud, there may be no loss if the offender has made, or has offered to make, restitution to the victim.<sup>88</sup> If restitution is allowed to become an automatic mitigating factor, however, the protection of investors may ultimately be threatened because brokers may come to consider restitution merely a cost of doing business.<sup>89</sup> Nevertheless, the offender's willingness to make restitution is a relevant factor when considered in conjunction with the primary purpose of sanctions—to protect investors rather than to punish offenders.

In addition to factors that describe the offense, the Commission has taken into account certain factors that tend to describe the offender; one such factor is the offender's attitude. The Exchange Act requires only that the misconduct be intentional before a sanction is imposed.<sup>90</sup> However, if the Commission finds a degree of willfulness greater than the statutory minimum, it should view this finding as relevant to the sanctioning purpose—the protection of investors.<sup>91</sup>

The offender's attitude may also be considered in terms of his willingness to reform. For example, a broker-dealer who has violated the Exchange Act by failing to supervise properly the sales practices of registered representatives may indicate his willingness to comply with the Act's requirements in the future by instituting improved procedures to supervise the sales force.<sup>92</sup> Similarly, the willingness of an offender to be retrained and closely supervised as a condition to being permitted to reenter the business indicates an attitude consistent with the Commission's remedial objectives.<sup>93</sup> Furthermore, an offender's willingness to consent to the imposition of a sanction may be an appropriate determinant of sanction severity to the extent that it demonstrates recognition of the law's requirements and a willingness to comply in the future.<sup>94</sup>

In addition to factors that describe the offender's attitude, the Commission also considers factors that describe his status. Former violations, for instance, are relevant to the extent that they tend to establish the likelihood of future offenses and, therefore, indicate

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88. See, e.g., *Boettcher & Co.*, 43 S.E.C. 875 (1968).

89. Cf. *Goldschmid*, *supra* note 78, at 946-47 (money penalties).

90. It has been said that willfulness "characterizes an act as being neither unintentional or inadvertent." *E. Weiss*, *supra* note 9, at 206.

91. *Id.* at 204.

92. See, e.g., *Boettcher & Co.*, 43 S.E.C. 875 (1968).

93. See, e.g., *Roy V. Montgomery*, SEC Exchange Act Release No. 8223 (Jan. 3, 1968). Indeed, willingness to reform was one of the factors most likely to mitigate the severity of sanction. See *SEC Case Study*, *supra* note 6, at 486-87.

94. Willingness to consent appeared in 66.3 per cent of all cases and tended to be associated with a reduction in expulsion rate. See *SEC Case Study*, *supra* note 6, at 485-86.

future danger to investors generally.<sup>95</sup> The age and experience of the offender can also be relevant;<sup>96</sup> however, the case study revealed that these factors were not considered by the Commission as often as was possible.<sup>97</sup> Accordingly, including age and experience as factors required by rule to be considered by the Commission might help to ensure that they are weighed when appropriate. The individual's general reputation in the industry is yet another factor that, when objectively identified, ought to be, and is, considered by the Commission in imposing sanctions.<sup>98</sup>

The factors described above are not necessarily the only ones that might be appropriate for the Commission's consideration. They are, however, relied upon by the Commission, and in many cases they are relevant factors in determining a sanction that will further the public interest. Moreover, no single factor is controlling; the combination of factors in any particular case must be considered to determine the appropriate weight to be given to each factor individually. Although it might be possible for regulated individuals to distill from SEC practice those factors the Commission is likely to consider, a rule is needed that will articulate the relevant factors that affect sanction severity so that they may be both known and knowable; furthermore, such a rule should require that the Commission consider these factors in each case in which they are present, thereby providing a formal standard to guide discretion that will be applicable to all. The formulation and publication of such a rule would not only guide the Commission, but would also serve as notice to regulated parties and provide a basis for judicial review.

### 3. *Procedural Requirements of a Rule*

If a rule of the type described is to provide an effective limit on the exercise of sanctioning discretion, it should include a requirement that the Commission make findings, supported by substantial evi-

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95. *See, e.g.*, *Strathmore Sec., Inc.*, 43 S.E.C. 575, 591 (1967).

96. *See, e.g.*, *David G. Baird*, 43 S.E.C. 815 (1968).

97. Age was mentioned in 2.6 per cent of the cases; experience was mentioned in 11.6 per cent of the cases. *SEC Case Study, supra* note 6, at 491.

98. *Id.* at 490-91. This is not to suggest that reputation, in and of itself, should determine the necessity of a sanction. Reputation is a valid criterion only when it tends to assist the Commission in determining the remedial necessity of a sanction. Thus, good reputation subsequent to a violation may be relevant to the ultimate determination of rehabilitation. Likewise, a history of scrapes with the law may indicate a pattern of behavior that is likely to endanger investors in the future. There is no question that reputation is a slippery factor. Only when reliable, objective evidence of reputation tends to support the remedial determination should it be considered.

dence,<sup>99</sup> with regard to each relevant factor stated in the rule. Further, the Commission should be required to articulate, as part of its reasons for imposing a sanction, the sanctioning purpose hoped to be achieved.<sup>100</sup> These procedural requirements are essential if the scheme is to be workable. In order to make judicial review possible, the Commission must support its application of the formal standard by indicating its factual findings and the relation between those findings and the sanction imposed.

It is true, of course, that the SEC already makes findings and offers reasons for its sanctions pursuant to the public interest standard. However, presently the Commission is not required to account for all of the factors that past practice has established are relevant in determining an appropriate sanction in similar cases; nor is it required to articulate all of the factors that it considered relevant in imposing a sanction in the particular case. Rather, under existing practice, the Commission is free to select some factors as a justification for its decision while ignoring (or failing to mention) others. Thus, the case study showed that, while all cases disclosed some factors upon which the sanctioning decision was based, few, if any, cases accounted for all of the discoverable factors that the SEC had found relevant in similar cases. Consequently, the rational basis for the Commission's sanctioning decisions is suspect. Moreover, the case study showed that the factors utilized by the Commission were applied inconsistently, resulting in an over-all disparity.

The deficiencies in the Commission's present practice can be illustrated by considering two approaches to sanctioning based on the following hypothetical: An experienced, middle-aged salesman with no prior record is found to have sold \$100,000 worth of securities by fraud. He has offered to make restitution. Under the first approach, the salesman would receive thirty-days suspension because he has been employed as a salesman for twenty-five years without any prior violation, and no loss has been suffered by the investors. Under this approach, suspension is viewed as an adequate remedy to protect investors and further the public interest. Under the second approach, the salesman would be expelled. In spite of his offer of restitution,

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99. The substantial evidence standard is generally used by the courts in reviewing findings of fact made by federal agencies. See 5 U.S.C. § 706(2)(E) (1970). "Substantial evidence is more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938). A reviewing court must sustain the agency's findings if they are supported by substantial evidence on the record considered as a whole, taking "into account whatever in the record fairly detracts from its weight." *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 488 (1951).

100. See Frankel, *supra* note 3, at 43.

the seriousness of the offense and large amount of money involved would require that the salesman be barred from association with a broker-dealer for the protection of investors. When viewed in isolation, either of these alternatives is rational. Note, however, that under the first approach the amount of money involved and the seriousness of the offense are ignored and the emphasis is instead placed on the lack of a prior record and the offer of restitution. On the other hand, under the second approach, the amount of money involved and the seriousness of the offense are held to outweigh the offer of restitution, and the offender's long spotless record is ignored. Moreover, neither approach considers the offender's intent or the number of investors involved. Thus, neither takes into account all of the discoverable factors that the SEC has found relevant in similar circumstances. Finally, by failing to account for all of the relevant factors, neither approach provides a rationale that adequately explains the purpose or necessity for the particular sanction imposed. The result is inconsistent treatment, not of arguably similar cases, but of the same case.<sup>101</sup>

The rule that will be proposed will not automatically remove all elements of disparity and inconsistency from the sanctioning process. Nonetheless, a requirement that the Commission make findings with regard to each relevant factor stated in the rule, and support the imposition of a sanction with reasons in light of those factors, will aid in the elimination of gross disparities and unreasoned decisions.

### *C. A Proposed Rule and Statutory Amendment*

In light of the preceding discussion and the findings of the case study, it is recommended that the Commission (by rule) or Congress (by amendment to the Exchange Act) formulate standards to guide the exercise of SEC sanctioning discretion. Section 23(a) of the Exchange Act<sup>102</sup> empowers the Commission to promulgate such a rule, and the following may be a reasonable starting point:

#### *Proposed Rule 15b4-1*

##### *Imposition of Sanctions Under Sections 15(b) and 19(h)(2), (3) of the Act:*

(a) In determining an appropriate sanction in any proceeding pursuant to sections 15(b) or 19(h)(2), (3) of the Act, the Commission will support its decision to impose (or not to impose) a sanc-

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101. For examples of this kind of use of the factors, compare Van Alstyne, Noel & Co., 43 S.E.C. 1080 (1969), with Charles P. Lawrence, 43 S.E.C. 607 (1967).

102. Securities Exchange Act of 1934, § 23(a), 15 U.S.C. § 78w(a) (1970).



tion with adequate findings and reasons to show that it has considered the purpose of the sanction, as well as all relevant factors describing the offense and the offender.

(1) The remedial purposes that a sanction may serve shall include: (A) the protection of investors; (B) the general and special deterrence of future violations; and (C) the encouragement of voluntary compliance with the Act or the rehabilitation of offenders.

(2) Factors describing the offense shall include: (A) the seriousness of the offense; (B) the number of investors involved or affected; (C) the amount of money involved; (D) the financial loss, actual or threatened, to investors; (E) the profit to the offender; (F) the geographic scope of the violation; and (G) all other relevant factors consistent with the purposes of this Act.

(3) Factors describing the offender shall include: (A) former violations; (B) general reputation in the industry; (C) age and experience in the securities business; (D) willfulness of the offense; (E) willingness to reform or make restitution; and (F) all other relevant factors consistent with the purpose of this Act.

(b) In the case of an individual, bar will be an appropriate sanction where—

(1) there is a reasonable likelihood that the respondent will continue to violate the securities laws; or

(2) there was an intentional or gross disregard for the requirement of the securities laws; or

(3) for other good cause shown.

(c) In the case of a registered broker-dealer, revocation will be an appropriate sanction where—

(1) there was substantial participation by management in the violation under circumstances stated in (b) above; or

(2) there was gross disregard of the duty to supervise prescribed by Section 15(b)(4)(E) of the Act; or

(3) for other good cause shown.

(d) In the case of financial loss to investors, restitution or an offer of restitution will not mitigate the offense, except for good cause shown, when bar or revocation would otherwise be an appropriate sanction pursuant to the requirements of paragraphs (b) and (c) of this rule.

(e) Any person whose registration has been revoked or who has been barred from association with a broker-dealer may petition the Commission for a hearing to consider readmission to the securities business. No such petition may be considered earlier than one year after the imposition of the sanction. The Commission will support its decision to deny a hearing, or to deny readmission after a hearing, with findings and conclusions not inconsistent with the purpose of this Act or this rule.

(f) In any proceedings pursuant to this rule, the Commission will explain departures from prior policy, whether that policy is embodied in written opinions or otherwise.

The proposed rule is designed to limit the exercise of Commission discretion without sacrificing the necessary element of flexibility. It imposes two principal obligations upon the Commission. First, the Commission must make findings that describe both the offense and the offender. Second, the Commission must demonstrate the necessity of imposing a sanction in light of its findings and the remedial purposes served by sanctions. In general, the rule requires the SEC to base its decision on findings supported by substantial evidence and to offer reasons for its conclusion consistent with the statutory purpose. Departures from some of the rule's specific requirements are permitted when the SEC can demonstrate that such departures are not inconsistent with the remedial purposes of the Act and administrative sanctions generally. The rule thus provides not only a guide for the Commission, but also a basis for judicial review.

Paragraphs (b) and (c) of the rule are intended to regularize the basic circumstances in which bar and revocation are appropriate. They attempt to avoid an emphasis, inadvertent or otherwise, on punishment for the sake of punishment. Paragraph (e) is based on the same remedial philosophy. It recognizes that a given offender may show that he is no longer a threat either to investors or to the maintenance of fair markets.<sup>103</sup> The existing concept inherent in revocation or bar—once a danger to investors, always a danger to investors—does not accord with reality; this notion of the “incorrigible” offender seems to shift the emphasis to punishment as the primary sanctioning purpose.<sup>104</sup>

Paragraph (d) is intended to ensure that restitution will serve as a mitigating factor only in those cases in which it is supportive of the statutory purpose. Paragraph (f) is intended to assist in developing reasonable certainty and consistency in the sanctioning process without depriving the Commission of the flexibility necessary to adjust its policies to changing industry circumstances and enforcement needs.

The practical question, of course, is whether the SEC (or Congress) will proceed along the lines suggested on its own motion. The remainder of this Article is concerned with the judicial action that may appropriately be taken if the SEC does not so respond.

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103. The Commission already acknowledges the validity of this general concept in a sanction it “created”: bar with the right to petition for re-entry. *See, e.g.*, Ellis Friend, SEC Exchange Act Release No. 11,026 (Sept. 24, 1974); Cenco Investors & Associates, SEC Exchange Act Release No. 10,962 (Aug. 14, 1974); Cortlandt Investing Corp., 44 S.E.C. 45 (1969).

104. *See, e.g.*, Beck v. SEC, 430 F.2d 673 (6th Cir. 1970).

#### IV. JUDICIAL CONTROL OF SANCTIONING DISCRETION

The role of the judiciary in controlling the exercise of administrative sanctioning discretion will necessarily vary depending upon the action (or inaction) taken by Congress and the SEC. Thus, we must first ask whether the courts can require either Congress or the SEC to articulate formal standards and whether such standards, if required, must be embodied in formal regulations. Second, we must focus on the problem of judicial review of standards that have been adopted by the SEC. Finally, we must examine some of the constitutional difficulties that may be raised by present SEC sanctioning practice.

##### A. *Judicial Requirement of Standards To Guide Discretion*

A judicial requirement of known standards to guide sanctioning discretion might take either of two forms. First, the courts might resurrect or modify the nondelegation doctrine in order to require Congress or the Commission to promulgate standards in the form of regulations; second, the courts might require that sanctioning standards be articulated, at a minimum, via agency adjudication.

##### 1. *The Nondelegation Doctrine as a Vehicle for Requiring Standards*

Could the courts utilize the nondelegation doctrine in order to require Congress to set forth meaningful sanctioning standards in the Exchange Act? Professor Davis, perhaps speaking for a majority, has said that "[t]he non-delegation doctrine is almost a complete failure . . . . The time has come for the courts to acknowledge that the . . . doctrine is unsatisfactory and to invent better ways to protect against arbitrary administrative power."<sup>105</sup> In spite of such sentiments, at least one distinguished jurist, Judge Wright, believes that "the reported demise of the doctrine is a bit premature."<sup>106</sup> Although Judge Wright rejects the proposition that Congress cannot delegate any legislative power to the executive branch or an independent agency, he has stated that "Congress should [not] be permitted, in effect, to vote itself out of business"<sup>107</sup> by passing on to nonelected officials the power to determine fundamental policy. He suggests that the nondelegation doctrine, "[a]t its core, . . . is based on the notion that agency action must occur within the context of a rule of law previously formulated by a legislative body."<sup>108</sup> Accordingly, he

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105. K. DAVIS, *supra* note 62, § 2.00, at 40 (Supp. 1970).

106. Wright, Book Review, 81 YALE L.J. 575, 582 (1972).

107. *Id.*

108. *Id.* at 583.

cites with approval the dissenting opinion of Justice Harlan in *Arizona v. California*<sup>109</sup>—an opinion that suggests that the issue is not the delegation of legislative power per se, but the delegation of “unrestrained authority.”<sup>110</sup> Justice Harlan further suggests that the doctrine so understood serves two purposes: “First, it insures that the fundamental policy decisions in our society will be made not by an appointed official but by the body immediately responsible to the people. Second, it prevents judicial review from becoming merely an exercise at large by providing the courts with some measure against which to judge the official action that has been challenged.”<sup>111</sup>

The merits of Justice Harlan’s second purpose seem self-evident. The merits of his first purpose, however, depend on the use of the words “fundamental policy” to distinguish those decisions that may not be made by an appointed official from those decisions that may be so made. Apparently, the words are used to avoid the clearly erroneous position that the Constitution forbids any policy formulation by a body other than Congress.<sup>112</sup> The problem, though, is determining the difference between a “fundamental policy” and any other kind of policy. Are the standards that guide sanctioning practice themselves matters of fundamental policy that must be set by Congress and not by the SEC?<sup>113</sup> Or is the fundamental policy involved only that the securities industry be regulated and that sanctions for violations be imposed? If, as is likely, it is the second question that must be answered in the affirmative, then it would seem that Congress has fulfilled its obligation, and the courts, even accepting Justice Harlan’s theory, should not use the nondelegation doctrine to require Congress to articulate standards to guide SEC sanctioning discretion.

An early claim that the SEC’s sanctioning power was an unlawful delegation “because the statute declares no standards to guide” the selection of an appropriate sanction was rejected by the Second Circuit.<sup>114</sup> In that case, Judge Swan noted that “Congress has defined the conduct that is unlawful . . . ,”<sup>115</sup> and the “‘protection of investors’ is a sufficiently definite criterion to guide the Commis-

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109. 373 U.S. 546, 626 (1963).

110. 373 U.S. at 626.

111. 373 U.S. at 626 (emphasis omitted).

112. See generally K. DAVIS, *supra* note 62, § 2.00-3 (Supp. 1970) (surveying the traditional practice of delegating power).

113. If this is the case, it would surely seem inconsistent with judicial approval of standardless sentencing authority for juries. See, e.g., *McGautha v. California*, 402 U.S. 183 (1971).

114. *Wright v. SEC*, 112 F.2d 89, 94 (1940).

115. 112 F.2d at 94.

sion."<sup>116</sup> Subsequently, the Supreme Court upheld the validity of the public interest standard in an SEC case, noting not only that it would be "unreasonable and impracticable to compel Congress to prescribe detailed rules . . .,"<sup>117</sup> but also that the standard was "constitutionally sufficient if Congress clearly delineates the general policy."<sup>118</sup> Presumably, the Court meant by "general policy" the same thing that Justice Harlan meant by "fundamental policy." It is unlikely, therefore, that the traditional formulation of the nondelegation doctrine can be utilized in this context.

A related question is whether the courts can use a variation of the nondelegation doctrine to require the SEC to promulgate rules. Professor Davis has suggested that the courts should modify the nondelegation doctrine by requiring agencies to engage in rule-making to supply the necessary standards that are otherwise lacking in the enabling legislation. Thus, rather than use the nondelegation doctrine to strike down legislation in which Congress has not supplied adequate standards, Professor Davis would use the doctrine to require the agencies to promulgate more definite standards.<sup>119</sup>

Although Professor Davis' suggestion is innovative, it has been seriously criticized.<sup>120</sup> Its problems are both practical and theoretical. Some commentators have focused on the practical problems of required rule-making.<sup>121</sup> Would mandated rule-making, for instance, obligate an agency to engage in rule-making procedures whenever the enabling legislation granted discretion, or would the agencies continue to be able to develop some standards in adjudicative proceedings? In any event, how would the courts determine whether the rule promulgated was as specific as was necessary or feasible? Would required rule-making result in unreasonable demands upon the limited resources of already overworked agencies?

Answers to these questions depend, to a large extent, upon the particular agency (as well as the particular functions of an agency) under consideration.<sup>122</sup> For example, as applied to the SEC's sanctioning practice, a requirement that the agency utilize rule-making procedures to formulate standards to guide discretion would not place

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116. 112 F.2d at 95. Judge Swan relied on a Supreme Court decision that had held that the "public interest" standard (for the ICC) "is not a concept without ascertainable criteria" in the context of the obvious statutory purposes. *New York Cent. Sec. Corp. v. United States*, 287 U.S. 12, 24-25 (1932).

117. *American Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946).

118. 329 U.S. at 105.

119. See K. DAVIS, *supra* note 1, at 27-51.

120. See, e.g., Reiss, *supra* note 38.

121. See Sofaer, *supra* note 32, at 1309-12.

122. See generally text at notes 30-43 *supra*,

an unreasonable demand on the resources of the agency; rather, it would require the SEC to codify, regularize, and improve its existing practices in the form of a public rule. In the long run, the rule would probably result in a time savings because the inquiry of the decision-maker, as well as affected parties, would be directed to the rule as a guide to argumentation and opinion-writing.

Further, the standards promulgated under required rule-making would not necessarily result in the elimination of adjudication as a proper vehicle for developing policy and standards. The rule recommended above, for instance, specifically guarantees the SEC the flexibility to develop standards in adjudication. When the developing policy of an agency becomes routinized, however, all parties concerned benefit by the codification and publication of the policy in a formal rule; such publication is an aid not only to efficiency, but also to judicial review of the sanctioning process.<sup>123</sup> The potential danger in required rule-making is not that the rules ultimately adopted would necessarily eliminate flexibility, but that a rigid application of the rule-making requirement—if, for example, the courts required *all* discretion to be controlled by standards in the form of rules<sup>124</sup>—could eliminate the agency's flexibility to decide whether to proceed by adjudication or rule-making. Such a result, however unlikely, would be clearly undesirable. Rule-making (as opposed to adjudication) is not necessarily desirable, practicable, or necessary in every situation in which an agency has discretion.<sup>125</sup> Judicial intervention to determine when an agency ought to develop policy by rule-making rather than adjudication should be guided by existing judicial tests that recognize the appropriate role for both forms of law-making.<sup>126</sup>

Although the practical problems that might arise from required rule-making would not cause insurmountable difficulties in the case of SEC sanctioning practice, required rule-making based on the nondelegation doctrine has a basic theoretical weakness. Regardless of one's preferred approach to nondelegation, the doctrine is not, as a matter of definition, responsive to the problem. If nondelegation means that Congress may not delegate legislative power,<sup>127</sup> then the

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123. Cf. *Environmental Defense Fund, Inc. v. Ruckelshaus*, 439 F.2d 584, 598 (D.C. Cir. 1971), where Chief Judge Bazelon notes that "principled decision-making" by agencies would "diminish the importance of judicial review . . ."

124. The courts have never adopted this position. See, e.g., *NLRB v. Insurance Agents' Intl. Union*, 361 U.S. 477, 499 (1960).

125. See text at notes 30-43 *supra*.

126. *SEC v. Chenery Corp.*, 332 U.S. 194, 202-03 (1947). See generally Robinson, *The Making of Administrative Policy: Another Look at Rulemaking and Adjudication and Administrative Procedure Reform*, 118 U. PA. L. REV. 485 (1970).

127. *Panama Ref. Co. v. Ryan*, 293 U.S. 388, 421 (1935).

problem of an unlawful delegation of authority is not cured by permitting an agency to determine standards to delimit the boundaries of power that it should not have been given to begin with. If, on the other hand, it is both constitutionally proper and also, as a practical matter, necessary that Congress delegate legislative power to an agency (assuming Congress has made the fundamental policy determinations),<sup>128</sup> then delegation is no longer the issue. The problem is not a question of the validity of delegating power, but of controlling the exercise of agency power that has been validly delegated. If, as Professor Davis suggests, the nondelegation doctrine "had to fail, should have failed, and did fail,"<sup>129</sup> why not be done with it? Why twist the doctrine further by attempting to apply it to a problem for which it was never intended? The attempt to find a basis for requiring standards to guide the exercise of agency discretion ought not to be rooted in an unnecessary complication of past mistakes.

To reject the nondelegation doctrine as a basis for mandating either agency rule-making or legislative action, however, is not to say that there is no judicial role in this area. The appropriate and logical source of a requirement that an agency articulate standards to guide sanctioning discretion is the due process clause.<sup>130</sup>

## 2. *The Due Process Clause as a Vehicle for Requiring Standards*

The due process clause is "intended to secure the individual from the arbitrary exercise of the powers of government."<sup>131</sup> Although the way in which this principle applies to administrative agency activities is not always clear, it has been established that, for example, an administrative proceeding to revoke a license is subject to due process requirements.<sup>132</sup> Thus, at a minimum, the licensee is entitled to notice and an opportunity to be heard "at a meaningful time and in a meaningful manner."<sup>133</sup> Due process also includes the right to have one's conduct judged by known standards, for, almost by definition, without standards there is no law.<sup>134</sup> Power without standards to

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128. *American Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946).

129. K. DAVIS, *supra* note 62, § 2.00-3, at 46 (Supp. 1970).

130. Professor Davis predicts that the nondelegation doctrine (as modified to require agency rule-making) "will merge with the concept of due process . . ." *Id.*, § 2.00-6, at 58. Surely the standards requirement ought to begin with the due process clause, not grow out of nondelegation.

131. *Bank of Columbia v. Okley*, 17 U.S. 235, 244 (1819).

132. *See Board of Regents v. Roth*, 408 U.S. 564, 571 (1972); *Schwartz v. Board of Bar Examiners*, 353 U.S. 232, 238 (1957).

133. *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965).

134. *See Wright*, *supra* note 106, at 589.

govern its exercise is "an intolerable invitation to abuse," and "[f]or this reason alone due process requires . . . 'ascertainable standards' . . ."<sup>135</sup>

The question remains, however, whether these principles should be applied to administrative sanctioning practice. Although a court would hardly tolerate an agency's determination of misconduct unless there existed a meaningful and ascertainable standard by which to measure the offender's actions, courts tend to be satisfied with very little in the way of standards to guide sanction selection; often, all that is necessary is the agency's certification that the particular sanction is necessary "in the public interest." Thus, in reviewing an SEC sanction, the Second Circuit dismissed the offenders' challenge simply by concluding that "the sanctions imposed upon the petitioners were well within the Commission's discretion."<sup>136</sup> The fact that a sanction is within the range of the Commission's discretion, however, ought not to end the due process inquiry. Did the agency demonstrate the necessity of the *particular* sanction imposed? What factors did the agency consider? How have comparable cases been dealt with? What is the nature of the offense and the offender? In short, what standards, if any, controlled the sanction's selection? The courts' reluctance to require the articulation of the standards and factors that guide the exercise of sanctioning discretion is, in effect, judicial acquiescence in governmental taking of property and liberty without standards, which is to say, without law.

It is an insufficient answer to say that judicial reluctance to require the articulation of standards for sanctioning decisions is due to the numerous and diverse factors that lead to a particular sanctioning choice.<sup>137</sup> Numerous and diverse factors must be considered by administrative agencies in many of the decisions that are made in the process of adjudication, and such adjudicative decisions are often no less complex than the decision to impose a sanction. The practicability of articulating standards in the light of statutory purposes, the SEC's need for flexibility, and the public interest in consistency have been discussed above.<sup>138</sup> Further, the fear that reviewing courts will substitute their opinions for the sanctioning decisions of the agency<sup>139</sup> should not insulate courts from fulfilling their duty to ensure that

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135. *Holmes v. Housing Authority*, 398 F.2d 262, 265 (2d Cir. 1968), quoting *Hornsby v. Allen*, 326 F.2d 605, 612 (5th Cir. 1964).

136. *Dlugash v. SEC*, 373 F.2d 107, 110 (1967).

137. *Cf. McGautha v. California*, 402 U.S. 183, 204 (1971).

138. *See* text at notes 30-43 *supra*.

139. *Cf. Rochin v. California*, 342 U.S. 165, 174-77 (1952) (Black, J., concurring).



the powers of government are exercised lawfully. The adoption of the due process basis for review of sanctions requires only that the reviewing court insist that valid criteria be articulated and applied by the agency in reaching its decision.

To say that the courts should require agencies to articulate standards is not necessarily to say that those standards must be articulated in formal regulations.<sup>140</sup> After all, rules governing conduct can be known and knowable not only if they are articulated in statutes and regulations, but also if they can be found in the opinions of judicial and quasi-judicial bodies. At a minimum, however, standards must be fairly deducible from such opinions. In this context, the importance of a requirement that agency sanctions be supported by clear reasons is apparent.<sup>141</sup> A statement of reasons both provides the necessary basis for judicial review<sup>142</sup> and serves the broader jurisprudential purpose of making the law known and knowable.

Although the statement of reasons requirement can be supported simply by reference to the provisions of the Administrative Procedure Act,<sup>143</sup> its basis in the due process clause should be acknowledged so that it cannot be construed to be merely a matter of legislative grace. At least one Supreme Court decision has based the statement of reasons requirement on the due process clause.<sup>144</sup> Indeed, it would be ironic if a defendant has the right to be told of the charges against him, but no corresponding right to be told why a sanction was being imposed.

Whatever else happens in the legal process, the imposition of a

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140. Both Professor Davis and Judge Wright suggest that due process might provide a basis for requiring rule-making. See K. DAVIS, *supra* note 62, § 2.00-6 (Supp. 1970); Wright, *supra* note 106, at 588.

141. It is generally held that a court may require a statement of reasons from an agency. See, e.g., SEC v. Chenery Corp., 318 U.S. 80, 94 (1943). Furthermore, the courts have required agencies to state their reasons clearly. See Secretary of Agriculture v. United States, 347 U.S. 645, 654 (1954); United States v. Chicago, M., St. P. & Pac. R.R., 294 U.S. 499, 511 (1935); Melody Music, Inc. v. FCC, 345 F.2d 730, 733 (D.C. Cir. 1965); Berko v. SEC, 297 F.2d 116, 118 (2d Cir. 1961); Kahn v. SEC, 297 F.2d 112, 114-15 (2d Cir. 1961) (Clark, J., concurring).

142. The practical significance of a statement of reasons as a prerequisite to meaningful judicial review is obvious. As Justice Cardozo stated, "We must know what a decision means before the duty becomes ours to say whether it is right or wrong." United States v. Chicago, M., St. P. & Pac. R.R., 294 U.S. 499, 511 (1935).

143. 5 U.S.C. § 557(c) (1970). The Act's reasons requirement does not apply to all agency actions, but it does apply to the SEC's sanctioning process under consideration because the imposition of sanctions represents agency action that is "required by statute to be determined on the record after opportunity for an agency hearing . . ." 5 U.S.C. § 554(a) (1970). The Exchange Act specifically requires a finding of the public interest prior to the imposition of a sanction, "on the record after notice and opportunity for hearing . . ." Securities Exchange Act of 1934, §§ 15(b)(4), (5), 15 U.S.C.A. §§ 78o(b)(4), (5) (Supp. Aug. 1975).

144. See *Kent v. United States*, 383 U.S. 541, 557 (1966).

sanction is, from the respondent's point of view, probably the single most important event; however, under existing conditions, it is the one event that is least controlled by the rule of law. If a system of law and due process of law are to be given meaning, they must be defined in terms of the reasoned regulation of human conduct by known standards. Reason alone will not guarantee that the law will be right in any absolute sense, but the failure to include articulated reasons and standards as a requirement of government action makes fully possible arbitrary, capricious, and, thus, unlawful government action. Even if standards and reasons are articulated, however, the possibility of abuse is not necessarily eliminated, since the standards adopted (and the reasons articulated in applying such standards) must be proper and must be properly utilized.

### B. *Judicial Review of Administrative Formulation and Utilization of Standards*

Although the debate continues regarding the extent to which the Administrative Procedure Act precludes review of matters committed to agency discretion,<sup>145</sup> it appears that SEC sanctioning discretion is reviewable for abuse.<sup>146</sup> As noted briefly above,<sup>147</sup> however, the

145. The source of the debate is the apparent conflict between two provisions of the Act, 5 U.S.C. § 701(a)(2) (1970), which precludes review "to the extent that . . . agency action is committed to agency discretion by law," and 5 U.S.C. § 706(2) (A) (1970), which requires a reviewing court to "hold unlawful and set aside agency actions, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . . ." A spirited dialogue on the question was engaged in by Professor Davis and Raoul Berger. See Berger, *Administrative Arbitrariness and Judicial Review*, 65 COLUM. L. REV. 55 (1965); Berger, *Administrative Arbitrariness—A Reply to Professor Davis*, 114 U. PA. L. REV. 783 (1966); Davis, *Administrative Arbitrariness—A Final Word*, 114 U. PA. L. REV. 814 (1966); Berger, *Administrative Arbitrariness—A Rejoinder to Professor Davis' "Final Word,"* 114 U. PA. L. REV. 816 (1966); Davis, *Administrative Arbitrariness—A Postscript*, 114 U. PA. L. REV. 823 (1966); Berger, *Administrative Arbitrariness—A Sequel*, 51 MINN. L. REV. 601 (1967); Davis, *Administrative Arbitrariness Is Not Always Reviewable*, 51 MINN. L. REV. 643 (1967). While the Supreme Court has held that the exception from reviewability is a narrow one, see *Citizens To Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 410 (1971), that case does not completely resolve the conflict. See Mahinka, *The Problem of Nonreviewability: Judicial Control of Action Committed to Agency Discretion*, 20 VILL. L. REV. 1 (1974).

146. See, e.g., *Hiller v. SEC*, 429 F.2d 856 (2d Cir. 1970); *Armstrong, Jones & Co. v. SEC*, 421 F.2d 359, 365 (6th Cir. 1970); *Nees v. SEC*, 414 F.2d 211, 217 (9th Cir. 1969).

Even if one follows Professor Davis' somewhat restrictive interpretation of the APA, SEC sanctioning discretion seems reviewable. Applying Professor Davis' two-part inquiry for determining reviewability, (1) it is clear that no "congressional intent is discernible to make [a sanction] unreviewable," and (2) "the subject matter is . . . [appropriate] for judicial consideration." K. DAVIS, *supra* note 62, § 28.16, at 965 (Supp. 1970). There is no language in section 15(b) of the Exchange Act that precludes review of sanctions, and section 25(a) of the Exchange Act specifically

courts seem unwilling to do much more than ensure that the sanction imposed is within the permissible statutory range of discretion.<sup>148</sup>

Is it practicable for the courts to do more? In *Wong Wing Hang v. Immigration and Naturalization Service*,<sup>149</sup> Judge Friendly found that the courts could invalidate discretionary agency actions that "were made without a rational explanation, inexplicably departed from established policies, or rested on an impermissible basis such as an invidious discrimination against a particular race or group, or, . . . on other 'considerations that Congress could not have intended to make relevant.'"<sup>150</sup> Although Judge Friendly did not attempt to provide a "comprehensive definition"<sup>151</sup> of abuse of agency discretion, the formula that he did provide seems to suggest two primary bases for judicial inquiry. First, discretionary action must be rational, and second, discretionary action must be consistent with relevant legal standards, whether the source of such standards is administrative, statutory, or constitutional.<sup>152</sup> If this formula is applied to SEC

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provides for review of Commission orders. 15 U.S.C.A. § 78y(a) (Supp. Aug. 1975). Further, the subject matter seems to require the kind of inquiries that "legally-trained judges, limited to the process that courts customarily use, are qualified to do." K. DAVIS, ADMINISTRATIVE LAW TEXT § 28.05, at 515-16 (1972). Moreover, if due process requires standards to guide discretion, there would appear to be "law to apply," the test suggested by the Supreme Court in *Citizens To Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 410 (1971).

147. See text at note 136 *supra*.

148. See, e.g., *Don D. Anderson & Co. v. SEC*, 423 F.2d 813, 817 (10th Cir. 1970); *Armstrong, Jones & Co. v. SEC*, 421 F.2d 359, 365 (6th Cir. 1970); *Nees v. SEC*, 414 F.2d 211, 217 (9th Cir. 1969); *Dlugash v. SEC*, 373 F.2d 107 (2d Cir. 1967); *Tager v. SEC*, 344 F.2d 5 (2d Cir. 1965); *Pierce v. SEC*, 239 F.2d 160, 163-64 (9th Cir. 1956); *Wright v. SEC*, 112 F.2d 89 (2d Cir. 1940).

A 1973 Supreme Court decision reiterated an arguably broader rule for reviewing an administrative sanction. A sanction may be reviewed only if "unwarranted in law or . . . without justification in fact . . .," *Butz v. Glover Livestock Commn. Co.*, 411 U.S. 182, 185-86 (1973), quoting *American Power & Light Co. v. SEC*, 329 U.S. 90, 112-13 (1946). Scrutiny of the factual basis for imposing a sanction is clearly justified. See text at note 176 *infra*. Whether a sanction is "warranted in law" would seem to permit an inquiry broader than a mere determination that the sanction is within the permissible statutory range of choices. The possible avenues such a broadened inquiry might take is the subject of the discussion that follows. The application of the "warrant in law" test in *Butz* was limited to a determination that the sanction there imposed was within the Secretary's range of authority and that such a sanction was "not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases." 411 U.S. at 187.

149. 360 F.2d 715 (2d Cir. 1966).

150. 360 F.2d at 719, quoting *United States ex rel. Kaloudis v. Shaughnessy*, 180 F.2d 489, 491 (2d Cir. 1950).

151. 360 F.2d at 719.

152. The *Wong* case itself exemplifies the first principle: "Wong contends that the determination here . . . is internally inconsistent—he was found to have possessed 'good moral character' during the several years prior to his application . . . yet was faulted for prevarication . . . during that same period." 360 F.2d at 719. Judge Friendly, in effect, gives three examples of the second principle: (1) inexplicable departures from agency policy; (2) invidious discrimination (constitutional); and (3) considerations Congress could not have intended to make relevant (statutory).

sanctioning discretion, it is obvious that a particular sanction either may lack a rational explanation or may be inconsistent with agency policy or with statutory or constitutional principles. It would seem, then, that SEC sanctioning discretion ought to be subject to a level of judicial inquiry that extends beyond the initial determination that the sanction is within the statutory range of the Commission's discretion.<sup>153</sup>

Undoubtedly, the reluctance of the federal judiciary to inquire into the propriety of a particular agency sanction is an outgrowth, in part, of its experience in reviewing criminal sanctions. It has been said that, "[i]f there is one rule in the federal criminal practice which is firmly established, it is that the appellate court has no control over a sentence which is within the limits allowed by a statute."<sup>154</sup> If one closely inspects the actual federal practice, however, that observation appears to be a slight overstatement. Although federal appellate courts generally have been reluctant to review the propriety of a sentence that is within the statutory limits,<sup>155</sup> they have been willing to intervene on occasion.<sup>156</sup> A recent Sixth Circuit opinion, *United States v. Daniels*,<sup>157</sup> suggests the possible bases for review of criminal sentences and, in so doing, offers a framework for review of administrative sanctions as well.

The court in *Daniels* suggested two exceptions to the general federal rule of nonreviewability.<sup>158</sup> First, the reviewing court may ascertain whether the trial court relied upon proper factors; and, second, the reviewing court may determine whether the trial court evaluated all of the relevant information about the offender in light of the proper factors.<sup>159</sup> The court further suggested that the factors to be considered include appropriate sentencing purposes, such as rehabilitation, protection of the public, discipline of the offender, and deterrence of others.<sup>160</sup> Thus, the court provided a test for reviewing the appropriateness of a sentence even in cases in which the sentence

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153. The power to sanction is not "the authority . . . to act blindly or arbitrarily . . . [or] in disregard of . . . limitations recognized by law." ADMINISTRATIVE PROCEDURE ACT, LEGISLATIVE HISTORY, S. DOC. No. 248, 79th Cong., 2d Sess., at 368-69 (1946) (Chairman Walter explaining review provisions of APA prior to adoption).

154. *Gurera v. United States*, 40 F.2d 338, 340-41 (8th Cir. 1930). See *United States v. Tucker*, 404 U.S. 443, 447 (1972).

155. See cases collected in Annot., 21 A.L.R. Fed. 655, 664-69 (1974).

156. See *id.* at 685-88.

157. 446 F.2d 967 (1971).

158. 446 F.2d at 969, citing *Gore v. United States*, 357 U.S. 386, 393 (1958).

159. 446 F.2d at 970.

160. 446 F.2d at 972, citing *Williams v. New York*, 337 U.S. 241, 248 n.13 (1949).

is within the permissible statutory range. The object of the test is to achieve, as far as is feasible, a sanction that fits the offender.<sup>161</sup>

The quality of judicial review of administrative sanctions would be improved if the courts (and counsel) were more careful to analyze the precise nature of an alleged abuse of discretion. The framework suggested by the court in *Daniels*, in combination with Judge Friendly's "definition" of abuse of discretion, can provide the basis for such analysis. In general, the court's attention should be directed to two aspects of sanctioning practice: the propriety of the standards relied upon by the agency in reaching a decision and the propriety of the manner in which the standards were utilized. Because each of these broad lines of inquiry includes more specific aspects, it is proposed that the following outline of the test be used:

### 1. *Propriety of Sanctioning Standards*

- (a) Is the standard consistent with the relevant statutory purposes?
- (b) Is the standard consistent with the remedial purposes of sanctioning?
- (c) Is the standard consistent with constitutional principles?

### 2. *Propriety of Utilization of Sanctioning Standards*

- (a) Are the agency's findings in respect to the standard supported by substantial evidence?
- (b) Have all of the proper factors and standards been accounted for in the agency's findings and reasons?
- (c) Has the agency inexplicably departed from its established sanctioning policy or practice?
- (d) Are the reasons offered in support of the sanction internally consistent?<sup>162</sup>

The court's initial step in evaluating the propriety of a standard being used by the Commission should be to determine whether the standard is consistent with the relevant statutory purposes.<sup>163</sup> This

161. 446 F.2d at 970, citing *Williams v. New York*, 337 U.S. 241, 247 (1949).

162. Professor Davis has made a similar suggestion: "a) determine the reasonableness of the rules . . . as a guide to discretion, . . . c) ascertain whether the particular exercise of discretion arbitrarily departs from the administrative case law, . . . f) determine whether the findings are supported by substantial evidence, g) determine whether the stated reasons are based upon considerations which are reasonable and legal." K. DAVIS, *supra* note 62, § 28.16, at 981-82 (Supp. 1970).

163. This step would appear to be implicit in Judge Friendly's "impermissible basis . . . [or] 'considerations that Congress could not have intended . . .,'" *Wong Wing Hang v. Immigration & Naturalization Serv.*, 360 F.2d 715, 719 (2d Cir. 1966); Judge Celebrezze's "improper factors," *United States v. Daniels*, 446 F.2d 967, 970 (6th Cir. 1971); or Davis' "reasons . . . based upon considerations which are . . . legal," K. DAVIS, *supra* note 62, § 28.16, at 982 (Supp. 1970).

task is essentially one of statutory interpretation and thus is one that is clearly appropriate for judicial consideration.<sup>164</sup> The basic statutory term to be construed in evaluating the propriety of SEC sanctioning standards is "the public interest," since SEC sanctions must be imposed in light of that statutory standard. In a different setting, the Supreme Court has stated that "the term 'public interest' is not a concept without ascertainable criteria . . ." <sup>165</sup> and must be construed in light of "[t]he purpose of the Act, the requirements it imposes, and the context of the provision in question . . ." <sup>166</sup> Thus, for our purposes, "the public interest" must be construed in light of both the purpose of the Exchange Act (the protection of investors) and the context in which the term applies (the imposition of sanctions). Obviously, even so construed, the term leaves the Commission with a great deal of leeway; however, it at least draws an initial boundary within which the Commission must stay. When the Commission imposes a sanction in reliance upon a factor that describes the offense or the offender, that factor must be rationally related to the remedial purposes of the Exchange Act.<sup>167</sup> Although most of the factors relied upon by the Commission do appear to meet this test,<sup>168</sup> some of the factors used appear to be more questionable. In particular, it might be appropriate to ask whether the offender's geographic location (for example, New York) or professional affiliation (for example, NYSE membership) are factors relevant to the purposes of the Exchange Act.

A second and related inquiry concerning the propriety of an agency standard is whether the standard is consistent with appropriate sanctioning purposes.<sup>169</sup> As in the case of statutory purposes, the scope of permissible sanctioning purposes allows the Commission a wide range of discretion (and justification) in imposing sanctions.

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164. K. DAVIS, *supra* note 62, § 28.16 at 965 (Supp. 1970).

165. *New York Cent. Sec. Corp. v. United States*, 287 U.S. 12, 25 (1932) (interpreting the Transportation Act of 1920, ch. 91, 41 Stat. 456).

166. 287 U.S. at 24. *See American Power & Light Co. v. SEC*, 329 U.S. 90, 104-05 (1946).

167. The SEC must, of course, properly interpret those purposes. Problems of interpretation and application of law are discussed in *NLRB v. Hearst Publications, Inc.*, 322 U.S. 111 (1944); Nathanson, *Administrative Discretion in the Interpretation of Statutes*, 3 VAND. L. REV. 470, 473-75 (1950).

168. *See text at notes 82-98 supra.*

169. This inquiry was of obvious importance to the court in *Daniels*, which said, "[W]e are disturbed by the District Court's failure to conceive of the sentencing procedure in terms of the modern penological philosophy praised by the United States Supreme Court," and listed the following factors as appropriate sentencing considerations: "(a) the reformation of the offender, (b) the protection of society, (c) the disciplining of the wrongdoer, and (d) the deterrence of others . . ." *United States v. Daniels*, 446 F.2d 967, 972 (6th Cir. 1971), *citing Williams v. New York*, 337 U.S. 241, 248 n.13 (1949).

Nevertheless, requiring that the standard be measured in light of appropriate sanctioning purposes does limit SEC action. In *Beck*, for example, the court of appeals overruled the Commission because the purpose of the sanction was punitive and therefore inappropriate.<sup>170</sup> The topic of appropriate sanctioning purposes was discussed earlier,<sup>171</sup> and there is no need to repeat that analysis here. It would seem however, that because sanctioning purposes may affect the nature and necessity of a particular sanction in any given case, it is appropriate for the courts to inquire about a sanction's purpose.<sup>172</sup>

Finally, the court may evaluate the propriety of sanctioning standards in light of relevant constitutional principles. This line of inquiry is consistent with Judge Friendly's statement that an abuse of discretion would occur if a decision "rested on an impermissible basis such as an invidious discrimination against a particular race or group. . . ."<sup>173</sup> Judge Friendly's "impermissible basis" standard clearly comprehends a challenge to one or more sanctioning standards on the ground that such standards are constitutionally defective. Inquiries into the constitutional validity of sanctioning standards are particularly appropriate for judicial determination.<sup>174</sup> Thus, a standard that infringes upon constitutional rights (including, for example, the freedoms of speech or religion) should be subject to challenge notwithstanding that the imposition of sanctions is action "committed to agency discretion by law."<sup>175</sup>

The second broad line of inquiry a court should make in reviewing an administrative sanction is to evaluate the manner in which sanctioning standards are utilized. In the Commission's case, this could prove to be the most important inquiry. In evaluating the

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170. *Beck v. SEC*, 430 F.2d 673 (6th Cir. 1970), discussed in text at notes 48-59 *supra*.

171. See text at notes 46-81 *supra*.

172. Even if one disagrees with the particular result of the case, *Beck* demonstrates the feasibility of such an inquiry. See *Beck v. SEC*, 430 F.2d 673 (6th Cir. 1970). In *Butz v. Glover Livestock Commn. Co.*, 411 U.S. 182, 187 (1973), the Supreme Court implicitly recognized the appropriateness of an inquiry into the relation of the sanction to statutory purpose: "[T]he breadth of the grant of authority to impose the sanction strongly implies a congressional purpose to permit the Secretary to impose it to deter repeated violations of the Act, whether intentional or negligent." Further, "[t]he Secretary's practice, rather, apparently is to employ that sanction as in his judgment best serves to deter violations and achieve the objectives of that statute." 411 U.S. at 187-88. Finally, the Court cited approvingly the statement of the court of appeals that judicial review is available to determine whether the sanction "bears a reasonable relation to the practice sought to be eliminated. . . ." 411 U.S. at 186, n.3, quoting 454 F.2d 109, 114 (1972).

173. *Wong Wing Hang v. Immigration & Naturalization Serv.*, 360 F.2d 715, 719 (2d Cir. 1966).

174. See *K. DAVIS*, *supra* note 62, § 28.16, at 975 (Supp. 1970).

175. Judge Wright also warns of the danger of standardless regulation that "chills the exercise of constitutional rights." Wright, *supra* note 106, at 589.

utilization of a sanctioning standard (assuming that the standard is itself proper), a court should initially question whether the Commission's findings with respect to the standard are supported by substantial evidence. This is clearly an appropriate and necessary judicial consideration, and one that finds support in the Administrative Procedure Act.<sup>176</sup>

Assuming there is substantial evidence to support the findings with respect to the standards relied upon, the next logical question is whether all of the relevant factors and standards were utilized by the Commission in reaching its decision. This problem particularly troubled Judge Celebrezze in *Daniels*:

[W]e are seriously perturbed about the trial judge's avowal that since 1938 or 1939, his court has . . . sentenced to five years in the penitentiary every young man who has refused to obey an order of a draft board. That statement . . . suggests a general practice . . . of imposing a sentence *without particular reference to the circumstances surrounding the commission of the crime or of the background of the criminal defendant*.<sup>177</sup>

Judge Celebrezze was concerned with the consistent failure of the trial court to utilize all of the relevant factors. At least one danger in such a failure is that it "contradicts the judicially approved policy in favor of 'individualizing sentences.'" <sup>178</sup> Because the same danger is present, the same general principle ought to apply to sanctioning practice. Moreover, in the context of sanctioning practice, the failure to consider all of the relevant factors may also result in a related deficiency. If, rather than a *consistent* failure to consider all of the relevant factors in *all* cases, there is an *inconsistent* failure to consider all of the relevant factors in *some* cases, there is a danger that similar cases will not be treated similarly. In fact, as described earlier,<sup>179</sup> this problem seems to arise in some SEC cases.

A judicial requirement that all of the relevant factors and standards be considered by the agency would minimize the problems raised by the "comparable case" argument—the argument that offenders in similar cases, or other offenders in the same case, have been treated less severely.<sup>180</sup> The current response of the Commission

176. See 5 U.S.C. § 706(2)(E) (1970). Both Professor Davis and Judge Friendly appear to agree. See K. DAVIS, *supra* note 62, § 28.16, at 982 (Supp. 1970); Wong Wing Hang v. Immigration & Naturalization Serv., 360 F.2d 715, 717 (2d Cir. 1966). See also Butz v. Glover Livestock Commn. Co., 411 U.S. 182, 185-86 (1973); Hanly v. SEC, 415 F.2d 589, 599 (2d Cir. 1969).

177. United States v. Daniels, 446 F.2d 967, 971 (5th Cir. 1971) (emphasis added).

178. 446 F.2d at 971, quoting Williams v. New York, 337 U.S. 241, 248 (1949).

179. See text at notes 21-29 *supra*.

180. See, e.g., Dlugash v. SEC, 373 F.2d 107, 110 (2d Cir. 1967); Martin A. Fleishman, 43 S.E.C. 185 (1966).



and the courts to this argument has usually taken one of two forms: that the necessary remedial action "cannot be precisely determined by comparison with action taken in other cases"<sup>181</sup> or that there is no requirement that comparable cases be treated alike.<sup>182</sup>

The first response is obviously true if it means only that sanctioning practice can never be mathematically precise. What it does not explain, however, is why courts should not attempt to make sanctioning practice as precise as is practicable within the framework of individualized justice. Surely, if courts require agencies to account for all of the relevant factors in reaching a sanctioning decision, it will be easier to isolate like cases and thus easier to treat such cases similarly. That mathematical precision will never be reached is hardly an argument for not doing all that can be done. Courts, of course, often respond to a defendant's allegation that offenders in comparable cases were treated more leniently by stating that the difference "is irrelevant because the sanctions imposed upon the [defendant] were well within the Commission's discretion."<sup>183</sup> Again however, the fact that "[t]he Commission must have a very large measure of discretion in determining what sanctions to impose"<sup>184</sup> should not insulate completely the Commission's decisions. The courts should at least make sure that the Commission's discretion has been exercised reasonably and with an even hand.<sup>185</sup> By requiring the agencies to consider all of the relevant factors before imposing a sanction, the courts not only would be fulfilling their obligation to maintain the integrity of the legal process, but would also be aiding the agencies in fulfilling their own obligations to that process.

The second response to the comparable case argument—that there is no requirement that comparable cases be treated alike—requires two answers. First, the statement taken literally runs counter to the concept of a system of law applicable to all equally. Judicial approval of the policy of individualized sanctions<sup>186</sup> is not inconsistent with the concept of equality of treatment. The policy of indivi-

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181. Martin A. Fleishman, 43 S.E.C. 185 (1966).

182. See, e.g., *Shawmut Assn. v. SEC*, 146 F.2d 791, 796-97 (1st Cir. 1945). The Supreme Court has noted that "[m]ere unevenness in the application of the sanction does not render its application in a particular case 'unwarranted in law.'" *Butz v. Glover Livestock Commn. Co.*, 411 U.S. 182, 188 (1973). Arguably, the Court has left room for judicial intervention when the "unevenness" is more than "mere." See *Cross v. United States*, 512 F.2d 1212, 1217-18 n.8 (1975). But see 512 F.2d at 1224-25 n.15 (Russell, J., dissenting).

183. *Dlugash v. SEC*, 373 F.2d 107, 110 (2d Cir. 1967).

184. *Tager v. SEC*, 344 F.2d 5, 9 (2d Cir. 1965).

185. See Friendly, *Judicial Control of Discretionary Action*, 23 J. LEGAL EDUC. 63, 64 (1971).

186. See *United States v. Daniels*, 446 F.2d 967, 971 (6th Cir. 1971).

dualized sanctions means that the attempt to determine a proper sanction must go beyond mere identification of the statutory offense and must include all of the relevant information about the offense and the offender.<sup>187</sup> When the individualizing process is complete, however, there will still be groups of like cases. To be sure, the process is not mathematically precise, but, again, like cases should be treated alike to the extent practically possible.

Second, to say that comparable cases need not be treated alike raises a question about the extent to which an agency ought to follow its established policies and precedents. This, of course, is the third component of the test that a court might use to evaluate the propriety of the agency's utilization of sanctioning standards: has the agency inexplicably departed from its established policy or practice? Even if all of the relevant factors are accounted for, the agency may seek to impose a different sanction than it has imposed in similar cases in the past. Clearly, agencies are intended to have flexibility in carrying out their functions;<sup>188</sup> furthermore, while standards are developed by experience, "[t]he administrator is expected to treat experience not as a jailer but as a teacher."<sup>189</sup> Nonetheless, there is an important difference between modifying policy to meet changing regulatory needs, and *inexplicable* departures from established policy.<sup>190</sup> If the Commission determines that it is necessary to depart from its customary practice in sanctioning a particular type of offense, it ought to explain the factors that necessitated the change. Without such explanation, neither the court nor the defendant can determine whether discretion was exercised by "rules of reason"<sup>191</sup> or by whim and caprice.

The final judicial inquiry regarding the propriety of an agency's

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187. See *Williams v. New York*, 337 U.S. 241, 247 (1949); *United States v. Daniels*, 446 F.2d 967, 971 (6th Cir. 1971).

188. See *Shawmut Assn. v. SEC*, 146 F.2d 791, 796-97 (1st Cir. 1945).

189. *Shawmut Assn. v. SEC*, 146 F.2d 791, 796-97 (1st Cir. 1945).

190. *Wong Wing Hang v. Immigration & Naturalization Serv.*, 360 F.2d 715, 719 (2d Cir. 1966); K. DAVIS, *supra* note 62, § 28.16, at 981-82 (Supp. 1970).

The majority in *Butz v. Glover Livestock Commn. Co.*, 411 U.S. 182, 186 (1973), stated: "We search in vain for that requirement [of uniformity] in the statute." One does not find the requirement in the statute, however, but rather in the "principles and conceptions of the 'common law,' and the ultimate guarantees associated with the Constitution." 411 U.S. 182, 191 (Stewart, J., dissenting), quoting L. JAFFE, *JUDICIAL CONTROL OF ADMINISTRATIVE ACTION* 590 (1965). It is true, as a generalization, that "a sanction . . . is thus not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases," 411 U.S. at 187, but the thesis here is that a different result must follow when there is gross unexplained disparity in sanctions in *like* cases. Moreover, in *Butz*, the majority seems implicitly to recognize the importance of explaining prior agency sanctioning practice. See 411 U.S. at 186 n.4.

191. Friendly, *supra* note 185, at 64.

utilization of sanctioning standards is whether the reasons given in support of the sanction's imposition are internally consistent. This was the precise nature of the challenge entertained by the Second Circuit in *Wong Wing Hang*.<sup>192</sup> Wong, a Chinese citizen, had entered the United States under a false claim. Subsequent to his entry, Wong had, among other things,<sup>193</sup> given false information to officials of the Immigration and Naturalization Service (INS) about himself, his wife, and other Chinese immigrants. Wong did not dispute his deportability under the provisions of the Immigration and Nationality Act,<sup>194</sup> but he did apply for a (discretionary) suspension of deportation. Wong's eligibility to apply for the Attorney General's favorable exercise of discretion was conditioned on Wong's being "a person of good moral character."<sup>195</sup> Although the Special Inquiry Officer and the Board of Immigration Appeals "found that Wong's misconduct . . . was insufficient to condemn him as lacking 'good moral character,'"<sup>196</sup> his application was denied because of his prevarications. On appeal, "Wong contend[ed] that the determination . . . [was] internally inconsistent—he was found to have possessed 'good moral character' . . . yet was faulted for prevarication. . . ."<sup>197</sup>

Judge Friendly, however, held that the result was not necessarily "a self-contradiction" since the finding of good moral character merely made Wong eligible to apply for suspension of deportation and did not require the discretionary grant of suspension. Furthermore, Judge Friendly found that, independent of the "mere" eligibility requirements, false statements made to the INS might be an appropriate standard to guide the ultimate exercise of discretion to suspend deportation.<sup>198</sup>

Regardless of one's opinion of the result, the importance of *Wong Wing Hang* is in Judge Friendly's recognition that an exercise of discretion may be judicially reviewed to determine whether the agency's reasons for its actions are internally consistent. This seems appropriate, for clearly the agency should do more than demonstrate

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192. *Wong Wing Hang v. Immigration and Naturalization Serv.*, 360 F.2d 715 (1966).

193. He had also been convicted as a co-conspirator in the perpetration of passport frauds. 360 F.2d at 716.

194. Immigration & Nationality Act § 241(a)(2), 8 U.S.C. § 1251(a)(2) (1970).

195. Immigration & Nationality Act § 244(a)(1), 8 U.S.C. § 1254(a)(1) (1970).

196. 360 F.2d at 717.

197. 360 F.2d at 719.

198. 360 F.2d at 719.

that it has made findings and has considered all of the appropriate standards—it must also show that its decision was rational.

Finally, it should be noted that the proposed framework to guide judicial inquiry into alleged abuses of discretion does not purport to solve all cases mechanically; rather, it is intended to direct the inquiry and to require courts to do more than merely determine whether the sanctions chosen were within the permissible statutory range.<sup>199</sup>

### C. Equal Protection Challenges to Sanctioning Discretion

The most serious problem disclosed by the case study was the apparent disparity between sanctions imposed on NYSE members and those imposed on all other offenders. Because of the potential for a constitutional challenge based upon this disparity in SEC sanctions, the equal protection implications of SEC practice are discussed here separately.<sup>200</sup>

In the context of the SEC's sanctioning practice, an equal protection challenge would not be directed at a discriminatory classification contained in a formal rule, nor at the factors that the Commission has indicated it will use in guiding its discretion; rather, the challenge would be directed at the discriminatory patterns of SEC sanctioning practice. These patterns of actual practice are, in effect, the "law." This approach is not new; *Yick Wo v. Hopkins*,<sup>201</sup> decided nearly one hundred years ago, held that, "[t]hrough the law itself be fair on its face and impartial in appearance, yet, if it is applied and administered by public authority with . . . an unequal hand, so as to practically make unjust and illegal discriminations between persons in similar circumstances . . . the denial of equal justice is still within the prohibition of the Constitution."<sup>202</sup> However, despite the apparent

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199. The framework for review is not inconsistent with the rule for review, reaffirmed by the Supreme Court, that a sanction may not be overturned unless it is "unwarranted in law or . . . without justification in fact . . . ." *Butz v. Glover Livestock Commn. Co.*, 411 U.S. 182, 185-86 (1973). Review of the factual justification finds its counterpart in the substantial evidence inquiry suggested above. The other elements of the framework for review suggested above are elaborations on how to determine whether the sanction has warrant in the law, an inquiry that must go beyond a conclusion that the sanction is within the statutory range, or an unanalyzed conclusion that differences in sanction severity do not warrant reversal.

200. In the context of an equal protection challenge to a federal agency, it is important to note that "[w]hile the Fifth Amendment contains no equal protection clause, it does forbid discrimination that is 'so unjustifiable as to be violative of due process.'" *Frontiero v. Richardson*, 411 U.S. 677, 680 n.5 (1973) (Brennan, J.), quoting *Schneider v. Rusk*, 377 U.S. 163, 168 (1964). Recently, Justice Brennan stated: "This Court's approach to Fifth Amendment equal protection claims has always been precisely the same as to equal protection claims under the Fourteenth Amendment." *Weinberger v. Wiesenfeld*, 420 U.S. 636, 638 n.2 (1975).

201. 118 U.S. 356 (1886).

202. 118 U.S. at 373-74.

encouragement that *Yick Wo* may offer, an equal protection challenge is not without difficulties.

For one thing, although the Warren Court's two-tiered test for equal protection inquiries has been much criticized,<sup>203</sup> the Court has not abandoned the dual standard in spite of recent opportunities to do so. For example, in *San Antonio Independent School District v. Rodriguez*,<sup>204</sup> the Court reiterated its adherence to the two-tiered standard: "We must decide, first, whether the Texas system of financing public education operates to the disadvantage of some suspect class or infringes upon a fundamental right explicitly or implicitly protected by the Constitution, thereby requiring strict judicial scrutiny. . . . If not, the Texas scheme must still be examined to determine whether it rationally furthers some legitimate, articulated state purpose . . . ." <sup>205</sup> Thus, if the SEC's sanctioning practice is to be subjected to strict judicial scrutiny, it must be shown that either a suspect class or fundamental right is involved; if a suspect class or fundamental right is not present, then the less rigorous "mere rationality" standard will be applied. The Court is not likely, however, to expand the list of classes now recognized as suspect to include non-NYSE broker-dealers;<sup>206</sup> nor is employment likely to be recognized as "a fundamental right explicitly or implicitly protected by the Constitution."<sup>207</sup>

It is true that employment offered, controlled, or licensed by the government has received increased constitutional protection in the form of due process notice and hearing requirements.<sup>208</sup> Yet, the

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203. See, e.g., Gunther, *Foreword: In Search of Evolving Doctrine on a Changing Court: A Model for Newer Equal Protection*, 86 HARV. L. REV. 1 (1972); Wilkinson, *The Supreme Court, The Equal Protection Clause, and the Three Faces of Constitutional Equality*, 61 VA. L. REV. 945 (1975); *San Antonio Independent School Dist. v. Rodriguez*, 411 U.S. 1, 70-137 (1973) (Marshall, J., dissenting).

204. 411 U.S. 1 (1973).

205. 411 U.S. at 17.

206. The categories now recognized as suspect include: race, *Loving v. Virginia*, 382 U.S. 1 (1967); national origin, *Graham v. Richardson*, 402 U.S. 365 (1971); and alienage, *Graham v. Richardson*, 403 U.S. 365 (1971). It appears that not even classifications based upon gender or wealth are automatically suspect. Although *Frontiero v. Richardson*, 411 U.S. 677 (1973), classified sex as suspect, only four justices specifically agreed to that basis for the decision (one of whom, Justice Douglas, has since resigned from the Court), and *Weinberger v. Wiesenfeld*, 420 U.S. 636 (1975), failed to invoke the suspect class criterion. See *Reed v. Reed*, 404 U.S. 71 (1971) (sex); *James v. Valtierra*, 402 U.S. 137 (1971) (wealth).

207. *San Antonio Independent School Dist. v. Rodriguez*, 411 U.S. 1, 17 (1973).

208. See, e.g., *Perry v. Sindermann*, 408 U.S. 593 (1972); *Willner v. Committee on Character*, 373 U.S. 96 (1963); *Schwartz v. Board of Bar Examiners*, 353 U.S. 232 (1957); *Schlochower v. Board of Higher Educ.*, 350 U.S. 551 (1956); *Hornsby v. Allen*, 326 F.2d 605 (5th Cir. 1964).

expanded notions of liberty<sup>209</sup> and property<sup>210</sup> that form the basis for procedural due process protection do not necessarily require the Court to designate employment a fundamental right for equal protection purposes.<sup>211</sup> As the *Rodriguez* Court said:

It is not the province of this Court to create substantive constitutional rights in the name of guaranteeing equal protection of the laws. Thus, the key to discovering whether education is "fundamental" is not to be found in comparisons of the relative societal significance of education . . . . Rather, the answer lies in assessing whether there is a right to education explicitly or implicitly guaranteed by the Constitution.<sup>212</sup>

Arguably, in light of the intimate tie between employment and the ultimate enjoyment of both liberty and property,<sup>213</sup> the Court ought to scrutinize strictly the rational basis of any classification that infringes upon employment; indeed, liberty and property become empty vessels for the average citizen if employment is not carefully protected from arbitrary or unequal governmental interference or termination.<sup>214</sup> It is not likely, however, that the Court will find in the text of the Constitution a basis for declaring employment to be a funda-

209. "Without doubt, [liberty] denotes not merely freedom from bodily restraint but also the right of the individual . . . to engage in any of the common occupations of life, . . . and generally to enjoy those privileges long recognized . . . as essential to the orderly pursuit of happiness by free men." Board of Regents of State Colleges v. Roth, 408 U.S. 564, 572 (1972), quoting *Meyer v. Nebraska*, 262 U.S. 390, 399 (1923).

210. "To have a property interest in a benefit, a person . . . [must] have a legitimate claim of entitlement to it." Board of Regents of State Colleges v. Roth, 408 U.S. 564, 577 (1972). The Court in *Goldberg v. Kelly*, 397 U.S. 254, 265 (1970), cited with approval the following passage from Reich, *Individual Rights and Social Welfare: The Emerging Legal Issues*, 74 YALE L.J. 1245, 1255 (1964): "Society today is built around entitlement. The automobile dealer has his franchise, the doctor and lawyer their professional licenses, the worker his union membership, contract, and pension rights, the executive his contract and stock options . . . ."

211. In *Rodriguez*, for example, education was not thought to have the status of a fundamental right in spite of its obvious importance and in spite of the fact that education, like employment, receives due process hearing protections. See *Dixon v. State Board of Educ.*, 294 F.2d 150 (5th Cir.), cert. denied, 368 U.S. 930 (1961).

212. 411 U.S. at 33-34.

213. See *Arnett v. Kennedy*, 416 U.S. 134, 212-16 (1974) (Marshall, J., dissenting).

214. Justice Marshall, for instance, has advocated a "sliding scale test" for equal protection inquiries that would require the Court "in every case . . . to determine the extent to which constitutionally guaranteed rights are dependent on interests not mentioned in the Constitution. As the nexus between the specific constitutional guarantee and the nonconstitutional interest draws closer, the nonconstitutional interest becomes more fundamental and the degree of judicial scrutiny applied when the interest is infringed on a discriminatory basis must be adjusted accordingly." *San Antonio Independent School Dist. v. Rodriguez*, 411 U.S. 1, 102-03 (1973) (dissenting). Under such a formula, might not liberty be the "specific constitutional guarantee" and employment the "nonconstitutional interest"? Even the majority in *Roth* recognized liberty as encompassing "the right of the individual . . . to engage in any of the common occupations of life . . . ." Board of Regents of State Colleges v. Roth, 408 U.S. 564, 572 (1972).

mental right. Thus, under the terms of the two-tiered test that governs equal protection analysis, the propriety of the de facto classification of SEC broker-dealers would be evaluated by the less demanding "mere rationality" standard.

Although it has been said that when applying the mere rationality standard a classification will be upheld if its use is justifiable under any conceivable set of facts,<sup>215</sup> the test so stated is misleading. First, it detracts from the proper focus of the test, which is that a classification must bear a rational relationship to a permissible state objective,<sup>216</sup> or, as the Court has recently held, a "legitimate, articulated state purpose."<sup>217</sup> Second, although adhering to the mere rationality rubric, recent Supreme Court decisions have struck down classifications after engaging in an evaluative process substantially more rigorous than a search for "any conceivable" set of facts that would justify the use of the classification.<sup>218</sup> This arguably more demanding search for a rational basis is particularly important where, as here, fundamental societal interests are at stake.

Is there a rational relationship between the classification of NYSE broker-dealers and some articulated purpose of the securities acts that would justify imposing less severe sanctions on NYSE members as compared with all others? It might be argued, for example, that Congress may have recognized that NYSE members are, on the whole, better operated and less likely to violate the law than non-NYSE broker-dealers. Assuming, *arguendo*, the validity of that proposition, it tends to miss the point. The imposition of a sanction depends on a finding that a person has in fact violated the securities acts, regardless of how one might choose to characterize the membership groups to which the offender belongs. Thus, even if most NYSE members have higher standards of conduct than nonmembers, that does not dispose of the problem of sanctioning those NYSE members who do violate the law. Although the fact that NYSE members are

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215. *McGowan v. Maryland*, 366 U.S. 420, 426 (1961); *Lindsley v. Natural Carbonic Gas Co.*, 220 U.S. 61, 78-79 (1911).

216. *See, e.g.*, *Reed v. Reed*, 404 U.S. 71, 76 (1971).

217. *San Antonio Independent School Dist. v. Rodriguez*, 411 U.S. 1, 17 (1973) (emphasis added).

218. Recent decisions applying an apparently more rigorous scrutiny seem to involve classes that are at least arguably suspect, *see, e.g.*, *Weinberger v. Wiesenfeld*, 420 U.S. 636 (1975) (sex); *Weber v. Aetna Cas. & Sur. Co.*, 406 U.S. 164 (1972) (illegitimacy), but the Court appears to have gone beyond the traditional rationality scrutiny even when no "quasi-suspect" class is involved, *see Eisenstadt v. Baird*, 405 U.S. 438 (1972) (marital status). To be sure, the Court has not always accepted the invitation to apply stricter scrutiny. *See, e.g.*, *Kahn v. Shevin*, 416 U.S. 351 (1974) ("benign" sex-based classifications); *Schlesinger v. Ballard*, 419 U.S. 498 (1975) (sex distinctions in Navy promotions).

better regulated than other broker-dealers<sup>219</sup> may be a valid consideration in allocating limited SEC enforcement resources (and thus the Commission may decide to leave most regulation of NYSE members to the Exchange, or it may find it necessary to proceed against NYSE members less frequently), it does not provide a basis for less severe sanctions when the SEC finds that a NYSE member has violated the law. In addition, it should be remembered that when the Commission does institute administrative proceedings against Exchange members, the violations alleged are—like those of other respondents—usually egregious fraud.<sup>220</sup>

The fact that the NYSE may impose sanctions upon its members<sup>221</sup> in addition to any sanctions imposed by the SEC (either before or after the SEC acts) also fails to provide a reasonable basis to support less severe sanctions for NYSE respondents. For one thing, the case study found that in nearly ninety-six per cent of the SEC cases (ninety-five of ninety-nine) involving NYSE respondents, there had been no prior NYSE action. In the four cases in which proceedings by the NYSE preceded action by the Commission, the sanctions imposed by the SEC and the NYSE were comparable.<sup>222</sup> Furthermore, even if the NYSE should decide to institute proceedings subsequent to an SEC proceeding, the NYSE Constitution states that the NYSE's sanction may not be greater than that imposed by the Commission, and, in the case of suspension, the suspension imposed by the NYSE shall not "commence before or expire after the suspension imposed by [the SEC]."<sup>223</sup> Consequently, the fact that the NYSE may impose its own sanctions does not appear to provide a rational basis for the SEC's current sanctioning practice.<sup>224</sup>

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219. There are, however, those who do not believe NYSE firms are well regulated. See, e.g., H. BARUCH, *WALL STREET: SECURITY RISK* (1971).

220. See *SEC Case Study*, *supra* note 6, at 516 (Table MM).

221. See Securities Exchange Act of 1934, § 6(b)(6), 15 U.S.C.A. § 78f(b)(6) (Supp. Aug. 1975).

222. Although the Commission has the authority to suspend or expel a member from the NYSE, Securities Exchange Act of 1934, § 19(h)(2), 15 U.S.C.A. § 78s(h)(2) (Supp. Aug. 1975), the Commission took such action in only two cases examined in the case study.

223. New York Stock Exchange Constitution, art. XIV, § 16 (1973). If the Exchange does not fulfill its statutory duty to discipline its members, whether before or after SEC action, the Commission has the statutory power to discipline the Exchange itself (by suspending or withdrawing its registration). Securities Exchange Act of 1934, § 19(h)(1), 15 U.S.C.A. § 78s(h)(1) (Supp. Aug. 1975). The Commission has never used this power against the NYSE. The 1975 amendments to the Exchange Act added a provision permitting the Commission "to censure or impose limitations upon the activities, functions, and operations of" an exchange. Securities Exchange Act of 1934, § 19(h)(1), 15 U.S.C.A. § 78s(h)(1) (Supp. Aug. 1975). This may prove to be a more flexible, and therefore more realistic, sanction.

224. It is true, of course, that in a particular case in which the Exchange has already taken disciplinary action against a member, the Commission might decide that



Another possible explanation for the Commission's practice of de facto classification may be the importance of the Exchange to the securities market and to the economy generally. The Exchange is, of course, the most important center for trading in securities. In 1972, for instance, the NYSE's trading volume was \$168.9 billion—about 78 per cent of all exchange trading.<sup>225</sup> Thus, it might be argued that to expel (or even to suspend for long periods) member firms would interfere with this important economic institution. However, it appears equally plausible to suggest that, because of the enormous importance of the NYSE, its members ought to be vigorously regulated and disciplined when violations are found to have occurred.<sup>226</sup> If the purposes of the securities acts are to protect investors and to inspire confidence in fair markets for securities, then the most important members of the industry should not be the least likely to be sanctioned for misconduct.

A related argument in favor of treating NYSE members less severely is that NYSE members are more likely to affect the accounts of a large number of investors, in which case revocation could have a disruptive effect upon millions of customers. Again, however, the better approach would seem to be vigorous enforcement of the securities laws in the case of NYSE members precisely because the protection of so many investors is at stake. To be sure, one ought not to take lightly a decision to revoke the registration of a firm with branch offices throughout the country; indeed, the violation may have been limited to one branch or department. A decision to revoke the registration of a firm, however, is not the Commission's only alternative. If some, but not all, of the firm's personnel were involved, the individuals responsible for the violation may be the only ones expelled—a solution that achieves the purpose of the securities acts without necessarily affecting the registration of the firm. In fact, however, few individuals associated with NYSE firms are barred for offenses that result in bar when committed by their non-NYSE counterparts.<sup>227</sup>

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its own disciplinary proceeding is unnecessary. That determination, however, should go to the question whether to proceed, not what sanction to impose after deciding to proceed.

225. 39 SEC ANNUAL REPORT 154 (1973).

226. See Reynolds & Co., 39 S.E.C. 902, 916 (1960) ("[I]n large organizations it is especially imperative that the system of internal control be adequate and effective and that those in authority exercise the utmost vigilance whenever even a remote indication of irregularity reaches their attention").

227. Limited expulsion has been imposed in both fraud and nonfraud cases. Also, rather than suspend the operations of an entire firm office, the SEC has imposed sanctions on single departments or branch offices. These limited sanctions were adopted in twenty-seven NYSE cases, but only seven non-NYSE cases. The high

The upshot of this inquiry is that it is at least arguable that the Commission's de facto classification of NYSE broker-dealers fails to bear a rational relationship to any of the legitimate articulated purposes of the securities acts; therefore, even under the mere rationality test, this aspect of the Commission's practice would seem to violate the equal protection clause.

The theoretical difficulties of making an equal protection based challenge to the Commission's practice are, however, probably not the most substantial roadblocks; the real problem is the present judicial attitude toward review of sanctions (or sentences). For example, in *McGautha v. California*,<sup>228</sup> the Supreme Court refused to uphold a constitutional challenge to standardless jury sentencing in spite of the "undeniable surface appeal of the proposition."<sup>229</sup> Writing for the majority, Justice Harlan stated:

To identify before the fact those characteristics . . . which call for the death penalty, and to express [them] in language which can be fairly understood and applied by the sentencing authority, appear to be tasks which are beyond present human ability . . . .

. . . .

In light of history, experience, and the present limitations of human knowledge, we find it quite impossible to say that committing to the untrammelled discretion of the jury the power to pronounce life or death in capital cases is offensive to anything in the Constitution.<sup>230</sup>

Formulating reasonable standards to guide the exercise of sanctioning discretion is not an easy task, but it certainly is not a task beyond present human ability. As Justice Brennan suggested in his dissent in *McGautha*, the matter is capable of solution; the failure to make an attempt to find "imaginative procedures" designed "to assure evenhanded treatment"<sup>231</sup> is to tolerate "Government by whim . . . , the very antithesis of due process."<sup>232</sup> Thus, as Justice Brennan pointed out, by refusing to provide a meaningful form of judicial review over the sanctioning process, the Court in *McGautha* sustained "against a due process challenge such an unguided, unbridled, unreviewable exercise of naked power" as never before.<sup>233</sup>

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frequency for NYSE firms is explained in part by the fact that NYSE firms are more likely to have branch offices. They would not, however, necessarily be more likely to have departments.

228. 402 U.S. 183 (1971).

229. 402 U.S. at 196.

230. 402 U.S. at 204, 207.

231. 402 U.S. at 249.

232. 402 U.S. at 250.

233. 402 U.S. at 252.

## V. CONCLUSION

Devices for providing meaningful control over administrative sanctioning discretion are presently available, and administrative or legislative promulgation of sanctioning standards is both necessary and feasible. With or without standards embodied in formal regulations, however, the courts should recognize the necessity of exercising their authority to subject sanctioning practice to review.

In light of the existing framework to guide review of the exercise of administrative discretion, the reluctance of the courts to subject sanctioning discretion to meaningful review is curious.<sup>234</sup> The necessity for review seems obvious, and the basis for judicial review of other agency action (and the exercise of discretion in general) is an accepted part of administrative law. Those same principles of judicial review can be applied to the sanctioning process without sacrificing flexibility. In short, although discretion is necessary in the sanctioning process, such discretion must be exercised reasonably and lawfully, not arbitrarily. Thus, an agency's decision to choose an appropriate sanction ought to be guided by proper standards and supported by adequate findings and reasons.

It is sometimes suggested that requiring agencies to supply reasons for their discretionary decisions and subjecting those decisions to review would impose unnecessary costs upon the agency. When essential questions are raised that challenge the inherent fairness of our system of adjudication, however, arguments and equations about costs and benefits must themselves be weighted against the costs to a just legal system. In the case of the SEC, a requirement of standards and reasons would not place a substantial new burden upon the agency; the agency not only already has rule-making authority and rule-making mechanisms, but already formulates specific reasoned opinions that purport to justify its sanctions in light of the statutorily imposed public interest standard. If judicial scrutiny of the agency's standards and reasons imposes a cost upon the agency, that expense is balanced by the potential cost to offenders who may have been sanctioned arbitrarily.

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234. See *Butz v. Glover Livestock Commn. Co.*, 411 U.S. 182, 189-91 (1973) (Stewart, J., dissenting). Justice Stewart criticized the majority for ignoring "the valid principle of law . . . —the principle that like cases are to be treated alike," 411 U.S. at 190, and noted further that the Court's refusal, in effect, to permit meaningful review of sanctions represented "an odd result at a time when serious concern is being expressed about the fairness of agency justice," 411 U.S. at 191.