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

INTRODUCTION

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


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

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


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

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


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

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\(9\) See, e.g., In re M.V. Gray Investments, Inc., 44 S.E.C. 567, 575 (1971); In re Pollisky, 43 S.E.C. 458, 459-60 (1967); In re Underhill Sec. Corp., 42 S.E.C. 659, 695 (1965); In re White, 3 S.E.C. 466, 539-40 (1938). Proof by a preponderance or weight of the evidence is the common standard for civil proceedings. 9 J. Wigmore, supra note 7, § 2498. Under this standard the trier of fact “must believe that it is more probable that the facts are true or exist than it is that they are false or do not exist; but, it is not necessary to believe that there is a high probability that they are true or exist, or necessary to believe to a point of almost certainty, or beyond a reasonable doubt, that they are true or exist, or necessary to believe that they certainly are true or exist.” McBaine, supra note 7, at 261; see McCormick, supra note 7, § 339, at 794-95. Other administrative agencies have also used a preponderance standard. E.g., Walters v. McLucas, 597 F.2d 1230, 1232 (9th Cir.) (FAA revocation of pilots license), cert. denied, 444 U.S. 932 (1979); Alsbury v. United States Postal Serv., 530 F.2d 852, 855 (9th Cir.) (discharge of postal employee), cert. denied, 429 U.S. 828 (1976); Kephart v. Richardson, 505 F.2d 1085, 1089 (3d Cir. 1974) (termination of disability payments by HEW); Polcover v. Secretary of the Treasury, 477 F.2d 1223, 1231 (D.C. Cir.) (IRS discharge of employee), cert. denied, 414 U.S. 1001 (1973). But see Sea Island Broadcasting Corp. v. FCC, 47 Ad L.2d 831, 835-37 (D.C. Cir. 1980) (clear and convincing standard for FCC revocation of broadcasting license).

\(10\) The intermediate burden of proof standard, that of clear and convincing evidence, reduces the probability that an innocent party will be held liable. See Addington v. Texas, 441 U.S. 418, 423 (1979); In re Winship, 397 U.S. 358, 369-70 (1970) (Harlan, J., concurring). This standard requires a belief by the factfinder “that it is highly probable that the facts are true or exist; while it is not necessary to believe to the point of almost certainty, or beyond a reasonable doubt that they are true or exist, or that they certainly are true or exist; yet it is not sufficient to believe that it is merely more probable that they are true or exist than it is that they are false or do not exist.” McBaine, supra note 7, at 262-63; see Dacey v. Connecticut Bar Ass’n,
bility of the preponderance standard, which equally allocates the risk of error between the litigants, was recently upheld by the Fifth Circuit in Steadman v. SEC. Although the appellant argued that a higher burden of proof should be applied, the court held that the preponderance standard adequately protected the interests of those individuals facing the potential imposition of sanctions.

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

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

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

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

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

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

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

Although the District of Columbia Circuit cases have been decided as a matter of policy,17 the imposition of a higher standard would be mandatory if it is determined that the present procedural protection is inadequate to satisfy the mandates of the due process clause of the fifth amendment.18 Procedural due process is the ultimate safeguard against administrative unfairness.19 When administrative agencies seek to impose sanctions that infringe upon an individual's liberty or property, certain procedural safeguards are constitutionally required. These safeguards become more or less rigorous20 depending upon a balancing of three competing interests:21 the effect of the governmental action upon the individual's constitutionally protected interests;22 the fairness of the existing proceeding and the probable effect that any additional procedural safeguards will have in increasing the accuracy of the proceeding and further decreasing the risk of an erroneous deprivation of the individual's rights;23 and the governmental interests implicated in the proceeding, including the administrative feasibility of implementing additional procedures.24 This Note will apply the procedural due process balancing test to the imposition

16. See note 10 supra.
18. "[N]o person shall . . . be deprived of life, liberty, or property, without due process of law . . . ." U.S. Const. amend. V. The due process clause of the fifth amendment applies only to the federal government while the due process clause of the fourteenth amendment applies to the states. Although this Note focuses on federal enforcement of the Securities Acts, its analysis also may be applied to the local enforcement of state securities laws, commonly referred to as "blue sky" laws.
22. Id. at 335, 339-43.
23. Id. at 343-37.
24. Id. at 348-49.
of sanctions pursuant to SEC disciplinary hearings and conclude that
the SEC's use of a preponderance burden of proof is constitutionally
defective in light of the potential deprivations resulting from the im-
position of severe sanctions by the SEC.

I. THE INDIVIDUAL INTERESTS

A. The Interests Defined

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

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

\begin{itemize}
\item \textsuperscript{25} \textit{id.} at 335.
\item \textsuperscript{26} 441 U.S. 418 (1979).
\item \textsuperscript{27} \textit{id.} at 433.
\item \textsuperscript{28} \textit{id.} at 421.
\item \textsuperscript{29} \textit{Whitney v. SEC}, 604 F.2d 676, 680 n.14, 681 (D.C. Cir. 1979); \textit{Collins Sec.
Corp. v. SEC}, 562 F.2d 820, 824-26 (D.C. Cir. 1977); \textit{cf. Arthur Lipper Corp. v.
SEC}, 547 F.2d 171, 180 n.6 (2d Cir. 1976) (disciplinary actions visit serious conse-
quences on the party), \textit{cert. denied}, 434 U.S. 1009 (1978); \textit{SEC v. National Student
Mkt'g Corp.}, 457 F. Supp. 682, 701 n.43 (D.D.C. 1978) (an injunction is a less
severe deprivation than disciplinary sanctions). \textit{See generally} note 36 \textit{infra}.
\item \textsuperscript{30} \textit{See} notes 5, 6, \textit{supra} and accompanying text.
\item \textsuperscript{31} \textit{Whitney v. SEC}, 604 F.2d 676, 680-81 (D.C. Cir. 1979); \textit{Collins Sec. Corp. v.
\item \textsuperscript{32} \textit{See, e.g., Los Angeles Trust Deed & Mortgage Exch. v. SEC}, 285 F.2d 162
few exceptions, that all securities professionals be registered or licensed. Securities
Exchange Act of 1934, \textit{§} 15(b), 15 U.S.C. \textit{§} 78o(a) (1976) (requiring the registration of
any individual or company selling securities and providing exceptions for exclusively
interstate sales and exempt securities sales); Investment Company Act of 1940, \textit{§} 8,
15 U.S.C. \textit{§} 80a-8 (1976) (voluntary registration); Investment Advisers Act of 1940,
\textit{§} 203(a)-(b), 15 U.S.C. \textit{§} 80b-3(a)-(b) (1976) (requiring the registration of investment
advisers with exception made for advice given for intrastate operations to insurance
companies and to small numbers of clients on a private basis).
\item \textsuperscript{33} \textit{See} note 6 \textit{supra}.
\end{itemize}
larly, a prohibition against associating with other securities profession-
als precludes the individual from further employment in the field. The purposes of these sanctions predetermine their results. By pre-
vanting an individual from engaging in any aspect of the securities
industry, these sanctions deprive him of his right to pursue a
livelihood, a constitutionally protected interest that cannot be im-
paired absent procedural due process safeguards. Courts have frequently applied a higher burden of proof in analo-
gous proceedings that potentially result in the deprivation of a signifi-
cant interest. In the situation of attorney disbarment, for example,
a majority of the courts have recognized that the effect of disbarment
on the attorney’s right to pursue a livelihood requires greater pro-
cedural protection than that which a mere preponderance standard
provides. In deportation proceedings, the Supreme Court has ap-

34. See Whitney v. SEC, 604 F.2d 676, 680 (D.C. Cir. 1979); Collins Sec. Corp. v. SEC, 562 F.2d 820, 824-26 (D.C. Cir. 1977).
37. See In re Fisher, 179 F.2d 361, 370 (7th Cir.), cert. denied, 340 U.S. 825 (1950); In re Ryder, 263 F. Supp. 360, 361 (E.D.Va.), aff’d per curiam, 351 F.2d 713 (9th Cir. 1967); People ex rel. Cline v. Kerker, 315 Ill. 572, 574, 146 N.E. 439, 439 (1925); Attorney Grievance Comm’n v. Bailey, 285 Md. 631, 644, 403 A.2d 1261,
plied a clear, unequivocal, and convincing standard\textsuperscript{38} because of the loss of liberty engendered by the forced relocation of the individual and the resultant loss of contemporary ties.\textsuperscript{39}

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

\textsuperscript{38}1268 (1979); \textit{cf. In re Ruffalo}, 390 U.S. 544, 551 (1968); (disciplinary proceedings "are adversary proceedings of a quasi-criminal nature," and disbarment, designed to protect the public, is a punishment or penalty imposed on the lawyer); \textit{Ex parte Wall}, 107 U.S. (17 Otto) 265, 288 (1882) (disbarment of attorneys is permissible only in the clearest cases of misconduct to protect the integrity of the court); McComb v. Commission on Judicial Performance, 19 Cal. 3d Spec. Trb. Supp. 1, 6, 138 Cal. Rptr. 459, 464, 546 P.2d 1, 6 (1977) (clear and convincing evidence needed to remove a judge from the bench); \textit{State ex rel. Vining v. Florida Real Estate Comm'n}, 281 So. 2d 487, 491 (Fla. 1973) (revocation of a professional license affects the individual's livelihood and reputation subjecting such proceedings to a higher scrutiny); \textit{Mississippi Real Estate Comm'n v. Ryan}, 248 So. 2d 790, 793 (Miss. 1971) (fraudulent dealing must be clearly established to revoke a license); Margoles v. State Bd. of Medical Examiners, 47 Wis. 2d 499, 509, 177 N.W.2d 353, 358 (1970) (to revoke a medical license "procedural due process often requires confrontation and cross-examination of those whose word deprives a person of his livelihood"). \textit{See generally ABA Center for Professional Discipline, Disciplinary Law and Procedure Research System (1981); ABA Joint Committee on Professional Discipline, Professional Discipline for Lawyers and Judges 78-81, 130 (1979); Note, \textit{Disbarment in the United States: Who Shall do the Noisome Work?}, 12 Colum J.L. & Soc. Prob. 1 (1975). Other administrative agencies have also disbarred attorneys from practicing before them. \textit{E.g.}, \textit{Goldsmith v. United States Bd. of Tax Appeals}, 270 U.S. 117 (1926) (Internal Revenue Service); \textit{Koden v. United States Dep't of Justice}, 564 F.2d 228 (7th Cir. 1977) (Immigration and Naturalization Service); \textit{Herman v. Dulles}, 205 F.2d 715 (D.C. Cir. 1953) (International Claims Commission).


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


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

\textsuperscript{42}42. Although the disbarment of an attorney in one state can lead to disbarment in another state in which the individual is also licensed to practice, nationwide disbarment is not certain. \textit{See Theard v. United States}, 354 U.S. 278, 282 (1957).
vidual subject to SEC sanctions should be afforded the same proce-
dural protection as attorneys facing disbarment, and aliens facing de-
portation.

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

("Disbarment by federal courts does not automatically flow from disbarment by state
courts."); Florida Bar v. Wilkes, 179 So. 2d 193, 195 (Fla. Dist. Ct. App. 1965) (as a
matter of interstate comity or pursuant to the full faith and credit clause of the
Constitution, disbarment of an individual by a sister state may be held to be con-
clusive, but the forum state may choose not to follow the other state's judgment if it is
deemed "so deficient or lacking in notice or opportunity to be heard, that there was
such a paucity of proof, or that there was some other grave reason which would make
it unjust to accept the foreign judgment"), cert. denied, 390 U.S. 953 (1968). In re Kimball, 40 A.D.2d 292, 293, 339 N.Y.S.2d 302, 305 (1973) (the court did not give
full faith and credit to the disbarment of an individual by another state because
"[r]easons of policy regarded as significant in one State . . . may not prevail in
another State"). In the instances of both attorney disbarment and SEC sanctioning,
the individual is not disbarred forever. The SEC, acting pursuant to 17 C.F.R.
§ 240.15ab-1 (1980), may reinstate parties who have been excluded from the industry
(CCH) ¶ 80,115; Investment Advisers Act Release No. 438 (Feb. 26, 1975), [1974-
1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,115; see Tager v. SEC, 344
F.2d 5, 9 (2d Cir. 1965). The state and federal bars also permit reinstatement. See,
e.g., Levenson v. Mills, 294 F.2d 397, 399 (1st Cir. 1961), cert. denied, 368 U.S.
954 (1962); In re Spring, 90 Ariz. 387, 388, 365 P.2d 456, 457 (1962), In re Hiss,

44. See Whitney v. SEC, 604 F.2d 676, 681 (D.C. Cir. 1979), Collins Sec. Corp.
v. Darby, 516 F.2d 961, 963 (5th Cir. 1975); Lozano-Giron v. Immigration and
Naturalization Serv., 506 F.2d 1073, 1076 (7th Cir. 1974), McNeeil v. Butz, 480 F.2d
46. McNeeil v. Butz, 480 F.2d 314, 319 (4th Cir. 1973) (quoting Board of Regents
v. Roth, 408 U.S. 564, 573 (1972)).
47. Lalone v. United States, 164 U.S. 255, 261 (1896), Maxwell Land-Grant
Case, 121 U.S. 325, 380-82 (1887); Barr Rubber Prods. Co. v. Sun Rubber Co., 425
F.2d 111, 1120 (2d Cir.), cert. denied, 400 U.S. 878 (1970), Goodman v. Poland,
395 F. Supp. 660, 666 n.17 (D. Md. 1975); Pinney & Topliff v. Chrysler Corp., 176
F. Supp. 801, 803 (S.D. Cal. 1959); Yoo Hoo Bottling Co. v. Leibowitz, 342 Pa. 117,
119, 247 A.2d 469, 470 (1968) (per curiam); Beckett v. Department of Social Health
Servs., 87 Wash. 2d 184, 186-87, 550 P.2d 529, 531 (1976). The standard of clear and
to the individual."\textsuperscript{41} Engendered by such proceedings.

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

Moreover, the certainty of being stigmatized is greater when dealing with securities fraud than with common law fraud. Information is disseminated rapidly in the securities industry.\textsuperscript{52} This is heightened convincing evidence has also been applied in federal tax fraud proceedings. See, e.g., Mensik v. Commissioner, 328 F.2d 147, 150 (7th Cir.), cert. denied, 379 U.S. 827 (1964); Lessman v. Commissioner, 327 F.2d 990, 993 (8th Cir. 1964); Kurnick v. Commissioner, 232 F.2d 678, 681 (6th Cir. 1956).


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


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

The stigma caused by governmental action, however, does not in itself justify the imposition of further procedural safeguards. Stigma when combined with the deprivation of another significant liberty interest is sufficient to compel additional due process protection. In the case of SEC disciplinary hearings, the concomitant deprivation of livelihood engendered by the imposition of sanctions constitutes a deprivation of liberty sufficient to compel raising the burden of proof made by the SEC in its disciplinary action. See, e.g., N.Y. Times, April 29, 1977, § D, at 1, col. 1. See also Lacy, supra note 40, at 441-42.

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

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

55. Paul v. Davis, 424 U.S. 693, 712 (1976). The Court has taken a far more restrictive view of the constitutional questions involved when a stigma is imposed upon a party. Damage to an individual’s “reputation alone . . . is [not] either ‘liberty’ or ‘property’ by itself sufficient to invoke the procedural protection of the Due Process Clause.” Id. at 701. See generally Note, Reputation, Stigma and Section 1983: The Lessons of Paul v. Davis, 30 Stan. L. Rev. 191 (1977). The most recent case from the District of Columbia Circuit, Investors Research Corp. v. SEC, 628 F.2d 168 (D.C. Cir.), cert. denied, 101 S. Ct. 317 (1980), implies that the factors of stigma and deprivation of livelihood, although somewhat interrelated, can be independent grounds for imposing an intermediate burden of proof. Id. at 175 n.41.

B. Risk of Erroneous Deprivation

The second prong of the balancing test requires an analysis of whether the existing procedure adequately protects against erroneous deprivations of life, liberty, or property.57 The probable effect of any additional procedural protections in preventing such erroneous deprivations must also be examined. The risk of erroneous deprivation under the present system is substantial because the preponderance burden of proof, perhaps the lowest possible standard, allows the highest risk of error.58 In Steadman v. SEC,9 however, the Fifth Circuit concluded that an individual's interests are adequately protected by a preponderance standard because the decision in the disciplinary hearing is subject to judicial review.10 This reasoning is unpersuasive for two reasons. First, burdens of proof govern findings of fact.51 When a court reviews the actions of an administrative agency, however, it normally scrutinizes only the conclusions that have been drawn from the factual findings.62 Thus, appellate review cannot protect against erroneous findings of fact. Second, the very purpose of imposing additional procedural safeguards is to grant uniform protection, rather than ad hoc review.63 If the Fifth Circuit's rationale were carried to its logical conclusion, applying procedural due process safeguards to any proceeding that is subject to judicial review would be precluded.

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

58. See notes 7, 9-12 supra and accompanying text.
59. 603 F.2d 1126 (5th Cir. 1979), cert. granted, 100 S. Ct. 1849 (1980) (No. 79-1266).
60. Id. at 1139.
63. See La Blatt v. Twomey, 513 F.2d 641, 648-49 (7th Cir. 1975); United States v. Morse, 491 F.2d 149, 156 (1st Cir. 1974); Karr v. Schmidt, 460 F.2d 609, 615 (5th Cir.), cert. denied, 409 U.S. 989 (1972); cf. Montana v. United States, 440 U.S. 147, 153-54 (1979) (collateral estoppel "fosters reliance on judicial action by minimizing the possibility of inconsistent decisions"); Mullaney v. Wilbur, 421 U.S. 684, 697 n.23 (1975) (raising the burden of proof sets a uniform limitation on sentencing bodies).
64. See notes 7, 9-12 supra and accompanying text.
even if the particular standard-of-proof catchwords do not always
make a great difference in a particular case, adopting a 'standard of
proof is more than an empty semantic exercise.' In cases involving
individual rights, whether criminal or civil, '[t]he standard of proof
... reflects the value society places on individual liberty.'

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

II. The Governmental Interest

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

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

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

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


68. Id. at 347-48.

69. Id. at 347.
licit legislative action indicates a more compelling governmental interest. A firm congressional decision merits such deference because, as a practical matter, Congress is better able to weigh the competing interests by holding hearings, debates, and commissioning research projects.

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

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


75. Section 7(c) of the Administrative Procedure Act of 1946, 5 U.S.C. § 556 (1976), is entitled "Hearings: presiding employees; powers and duties; burden of proof; evidence; record as a basis of decision." The text of this section states in part that "[e]xcept as otherwise provided by statute, the proponent of a rule or order has the burden of proof." Id., 5 U.S.C. § 556(d) (1976).
has concluded that a preponderance of the evidence standard has been mandated by Congress. This assertion, however, is unfounded. The weight of the legislative history, as well as the majority of the cases dealing with this issue, indicates that Congress intended to impress upon the administrative agencies the expanded role of judicial review under the APA and to formulate a standard measuring the quality of the evidence, not a burden of proof. Moreover,


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

79. "The second and primary sentence [which in the Senate draft contained the phrase 'relevant, reliable, and probative evidence'] of the subsection is framed on the theory that an administrative hearing is to be compared with an equity proceeding in the courts. The mere admission of evidence is not to be taken as prejudicial error (there being no lay jury to be protected from improper influence) although irrelevant and unduly repetitious evidence is to be excluded as a matter of efficiency and good practice; and no finding or conclusion may be entered except upon evidence which is plainly of the requisite materiality and competence; that is, 'relevant, reliable, and probative evidence.' Thus while the exclusionary 'rules of evidence' do not apply except as the agency may as a matter of good practice simplify the hearing and record by excluding obviously improper or unnecessary evidence, the standards and principles of probity and reliability of evidence must be the same as those prevailing in courts of law or equity in nonadministrative cases." Senate Report, supra note 72, at 23, reprinted in APA Legislative History, supra note 72, at 205; see id. at 39, 43, reprinted in APA Legislative History, supra note 72, at 228 (Appendix to the Attorney General's Statement regarding the APA); Attorney General's Manual on the
such an assertion is undercut by the SEC’s recent opposition to two regulatory reform bills before Congress because they did not contain provisions that set a preponderance burden of proof for disciplinary proceedings. Consequently, it is tenuous to assert that the preponderance of the evidence standard in SEC disciplinary hearings reflects more than an administrative policy determination.

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

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


85. 435 U.S. at 543 (1978); see Natural Resources Defense Council, Inc. v. SEC, 606 F.2d 1031, 1048 (D.C. Cir. 1979).
for "constitutional constraints or compelling circumstances" that would allow a court to raise the burden of proof. Moreover, the Court has noted that the imposition of a higher burden of proof does not invade the "traditional discretion [of a sanctioning] bod[y]" because the facts have been determined under a constitutionally accepted burden of proof and the agency will be free to decide which sanction to adopt.

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

86. See Swinomish Tribal Community v. Federal Energy Regulatory Comm'n, 627 F.2d 499, 510 (D.C. Cir. 1980); Association of Nat'l Advertisers, Inc. v. FTC, 617 F.2d 611, 619 n.10 (D.C. Cir. 1979); National Indus. Sand Ass'n v. Marshall, 601 F.2d 689, 699 n.35 (3d Cir. 1979); note 35 supra and accompanying text.
88. Id.
89. Brief for Appellee at 23, Steadman v. SEC, No. 79-1266 (U.S., filed Feb. 15, 1980).
90. Id.
92. See notes 7, 9-12 supra and accompanying text.
The clear and convincing standard is a feasible burden of proof to apply in disciplinary proceedings. It has been applied in the District of Columbia Circuit for approximately three years. During this time, the SEC has frequently met this higher standard in proving violations of the Securities Acts. This intermediate standard also has been used successfully in common law fraud cases for over one hundred years. Theoretically, the imposition of a higher burden of proof may make it more difficult for the SEC to impose severe sanctions. Nevertheless, such a possibility does not militate against mandating a standard that will more accurately reflect the individual interests at stake in a disciplinary hearing.

CONCLUSION

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

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