STEADMAN v. SEC—ITS IMPLICATIONS AND SIGNIFICANCE

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I. Introduction

In Steadman v. SEC, the Supreme Court held that the preponderance of the evidence standard of proof was the proper standard to be employed in SEC administrative proceedings involving allegations of fraud. The Court’s decision was premised on a construction of section 7(c) of the Administrative Procedure Act (APA), and was not based on an interpretation of the federal securities laws.

The Court had granted certiorari in Steadman to resolve a conflict in the circuits. While the District of Columbia Circuit had required a clear and convincing evidence standard when fraud allegations were the subject of an administrative disciplinary proceeding,

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2. Id. at 4177-78.

3. Id. at 4176-77.

4. See Whitney v. SEC, 604 F.2d 676 (D.C. Cir. 1979); Collins Securities Corp. v. SEC, 462 F.2d 820 (D.C. Cir. 1977). See generally An Evidence Test for Regulators, Business Week, Mar. 2, 1981 at 105. In Collins, the D.C. Circuit emphasized that when fraud allegations are the subject of a disciplinary proceeding, and, more importantly, when the sanction sought to be imposed is the disbarment of a professional from practice, a “clear and convincing” rather than a “preponderance of the evidence” standard must be used. The underlying rationale for this decision was that a finding of fraud and the concomitant disbarment from practice constituted a severe deprivation to the respondent and was more than the procurement of mere prophylactic—
the Fifth Circuit had adhered to a preponderance standard in such

lactic relief by the Commission. Therefore, a higher degree of proof was required. Collins Securities Corp. v. SEC, 462 F.2d at 825-26. The D.C. Circuit subsequently extended the Collins rationale to encompass a nine-month suspension of a broker-dealer based on allegations of fraud. The court stated: "Like the revocation in Collins, a suspension for nine months imposes a serious loss, both as a short-run matter of foregone business and, perhaps more grievously, as a permanent injury to reputation." Whitney v. SEC, 604 F.2d at 681.

By way of background on this general subject, in Addington v. Texas, 441 U.S. 418 (1979), the Supreme Court held that due process requires that the clear and convincing standard apply to involuntary civil commitment to a state mental institution. In so holding, the Court observed that it "repeatedly has recognized that civil commitment for any purpose constitutes a significant deprivation of liberty that requires due process protection." Id. at 425. In its decision, the Court referred to the standard of proof employed in certain civil cases based on fraud. The Court stated:

One typical use of the [clear and convincing] standard is in civil cases involving allegations of fraud or some other quasi-criminal wrongdoing by the defendant. The interests at stake in those cases are deemed to be more substantial than mere loss of money and some jurisdictions accordingly reduce the risk to the defendant of having his reputation tarnished erroneously by increasing the plaintiff's burden of proof.

Id. at 424. But see Vance v. Terrazas, 444 U.S. 252, reh. denied, 445 U.S. 920 (1980), where the statute at issue specifically provided that the preponderance standard applied in certain expatriation proceedings. The Supreme Court, in holding that the preponderance standard abridged neither the Due Process nor the Citizenship Clause of the Fourteenth Amendment, noted that while "[i]t is true that in criminal and involuntary commitment contexts we have held that the Due Process Clause imposes requirements of proof beyond a preponderance of the evidence ... expatriation proceedings are civil in nature and do not threaten a loss of liberty." Id. at 266 (citations omitted).

Insofar as lower court decisions are concerned, in Sea Island Broadcasting Corp. v. FCC, 627 F.2d 240 (D.C. Cir.), cert. denied, 101 S. Ct. 105 (1980), the D.C. Circuit held that the clear and convincing standard applied to certain FCC license revocation proceedings. The court's decision appeared to have been based on the rationale that the licensee had a "security of interest" during the term of the license, stating that while revocation does not preclude the licensee from retaining his other licenses or obtaining other jobs in the industry, "he certainly has lost a business." Id. at 243. Also, of interest is Charlton v. PTC, 543 F.2d 903 (D.C. Cir. 1976), which involved the question of whether the Federal Trade Commission used the proper standard of proof in imposing upon an attorney a one-year suspension from practice before the Commission. The standard utilized by the FTC was that of "substantial evidence" which the Commission defined as "not 'the preponderance of the evidence,' but 'something less than the weight of the evidence,' [constituting] 'such relevant evidence as a reasonable mind might accept as adequate to support a conclusion'". Id. at 907. Reversing, the court of appeals held that the proper standard was that of preponderance of the evidence:

Disciplinary proceedings against attorneys do not involve any departure from the orthodox rule governing resolution of civil evidentiary contests. Almost seventy years ago, this court declared that the "charge should be supported by a preponderance of satisfactory evidence. The case should be clear and free from doubt." The same view, though variously articulated is the touchstone of judicial decisions across the Nation; the bare minimum for a finding of misconduct is the clear and convincing power of the evidence. That the proceeding is administrative rather than judicial does not diminish this wholesome demand, and the requirement should not have been relaxed in the case at bar. . . . We reverse the District Court's summary judgement [sic] against Charlton and remand the case for further proceedings. The District Court will vacate the Commission's disciplinary order and will, in turn, remand to the Commission with instructions that it reconsider the evidence and redetermine the charge by application of the preponderance-of-the-evidence rule.

Id. at 907-08 (citations omitted) (emphasis added).
cases.\(^5\) In addition, the proper standard of proof in non-fraud administrative actions was still open to question.\(^6\)

5. Steadman v. SEC, 603 F.2d 1126 (5th Cir. 1979), aff'd on other grounds, 49 U.S.L.W. 4174 (U.S. Feb. 25, 1981). The Commission, \textit{inter alia}, permanently barred Steadman from associating with any investment adviser and prohibited him from affiliation with any registered investment company for violating the antifraud, reporting, conflict of interest, and proxy provisions in his management of certain mutual funds registered under the Investment Company Act. The Fifth Circuit rejected the \textit{Collins} holding that the burden of proof in Commission administrative proceedings should be by "clear and convincing" evidence, notwithstanding allegations of fraud. The Fifth Circuit stated:

The burden of proof serves to allocate between the litigants the risk of erroneous decision in a proceeding. Balanced against the risk to Steadman is the risk that the investing public will be inadequately protected. The public interest in high standards of conduct in the securities business is a great one. If the burden of proof imposed on the Commission is too high, its ability to police the industry is impaired.

Id. at 1139.

Another issue raised by \textit{Steadman}, which was not before the Supreme Court, was that the Fifth Circuit, although applying the preponderance of the evidence standard, required the Commission to articulate compelling reasons to justify Steadman's permanent exclusion from the industry and to explain why a less drastic remedy would not suffice. The court stated:

We subscribe to the common-sense notion that the greater the sanction the Commission decides to impose, the greater is its burden of justification.

Where, as here, the most potent weapon in the Commission's 'arsenal of flexible enforcement powers' is used, the Commission has an obligation to explain why a less drastic remedy would not suffice.

Id. On this point, see \textit{American Power Co. v. SEC}, 329 U.S. 50 (1947); \textit{Hinkle Northwest, Inc. v. SEC}, [Current] Fed. Sec. L. Rep. (CCH) \# 97,949 (9th Cir. 1981); \textit{Ripp v. SEC}, 591 F.2d 1344 (9th Cir. 1979); \textit{Nasser & Co. v. SEC}, 566 F.2d 790 (D.C. Cir. 1977); \textit{Arthur Lipper Corp. v. SEC}, 547 F.2d 171 (2d Cir. 1976), \textit{cert. denied}, 434 U.S. 1009 (1978); \textit{Wright v. SEC}, 112 F.2d 89 (2d Cir. 1940); Comment, \textit{Scope of Review or Standard of Proof—Judicial Control of SEC Sanctions & Steadman v. SEC}, 93 HARV. L. REV. 1845 (1980). In regard to this issue in \textit{Steadman}, the Supreme Court stated: "Because the Commission imposed severe sanctions on petitioner, the Court of Appeals remanded to the Commission 'to articulate carefully the grounds for its decisions, including an explanation of why lesser sanctions will not suffice.'" 49 U.S.L.W. 4174 at n.8 (citing 603 F.2d 1126, 1143 (5th Cir. 1979)).


It is important to note that even if the Supreme Court in \textit{Steadman} had required that the clear and convincing standard be applied, the proper standard in non-fraud actions would still have been unresolved. Recently, the Commission noted this distinction:

There is no need to hold the present petition pending the disposition of \textit{Steadman v. SEC}, \textit{supra}. Petitioner Steadman contends that clear and convincing evidence is required in a Commission adjudactory proceeding involving allegations of "fraud" that leads to the imposition of an order barring a securities professional from participation in the investment advisory industry (Br. 8, 15, 24). Even if Steadman's contention were accepted by the Court, it would lend no support for the assertion in the present case, which would require clear and convincing evidence even in the absence of an allegation of fraud or an order resulting in a severe sanction. No court has ever suggested that violation of a statutory provision comparable to Section 17(e)(1) requires clear and convincing evidence.


Courts apparently agreed with this rationale. Thus, in \textit{Investors Research}, the D.C. Circuit distinguished \textit{Collins} in an SEC action based on violations of \S 17(e)(1) of the Investment Company Act. In upholding the preponderance of the evidence
II. Steadman—An Overview

The Court in Steadman relied on the language and legislative history of section 7(c) to base its decision. Turning to that provision’s language, the Court remarked that “the language of the statute itself implies the enactment of a standard of proof.” In so stating, the Court found petitioner’s argument that the provision set forth merely a standard of quality of evidence, in view of the clear import of the statutory language, unpersuasive. The Court, however, recognized that the provision’s language was somewhat “opaque” regarding the precise standard of proof, and thereupon turned to the test in this context, the court stated: “Collins required the higher standard in fraud actions where a severe sanction is imposed. Since neither one of these elements is found in this case, Collins is inapplicable.” Investors Research Corp. v. SEC, 628 F.2d 168, 175 n.41 (D.C. Cir. 1980) (emphasis in original).

In another case based on violations of §17(e)(1) of the Investment Company Act, the Tenth Circuit, relying on the D.C. Circuit’s decision in Investors Research, likewise concluded that the preponderance of the evidence test is the proper standard. Decker v. SEC, 631 F.2d 1380, 1383-84 (10th Cir. 1980).


7. Section 7(c) provides in pertinent part:

Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence. A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence.


8. 49 U.S.L.W. at 4176.

9. Id. The Court further stated:

The phrase “in accordance with” lends further support to a construction of §7(c) as establishing a standard of proof. Unlike §10(e), the APA’s explicit “Scope of review” provision that declares that agency action shall be held unlawful if “unsupported by substantial evidence,” §7(c) provides that an agency may issue an order only if that order is “supported by and in accordance with . . . substantial evidence.” The additional words “in accordance with” suggest that the adjudicating agency must weigh the evidence and decide, based on the weight of the evidence, whether a disciplinary order should be issued. The language of §7(c), therefore, requires that the agency decision must be “in accordance with” the weight of the evidence, not simply supported by enough evidence “to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury.” Obviously, weighing evidence has relevance only if the evidence on each side is to be measured against a standard of proof which allocates the risk of error. Section 10(e), by contrast, does not permit the reviewing court to weigh the evidence, but only to determine that there is in the record “such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.” It is not surprising, therefore, in view of the entirely different purposes of §7(c) and §10(e) that Congress intended the words “substantial evidence” to have different meanings in context. Thus, petitioner’s argument that §7(c) merely establishes the scope of judicial review of agency orders is unavailing.

Id. at 4176-77 (emphasis added & citations omitted).
legislative history. Upon reviewing that history, the Court concluded that Congress clearly intended to adopt a preponderance of the evidence standard.  

To support further its construction of congressional intent, the Court referred to the Commission’s long-standing practice of employing the preponderance standard. In this regard, the Court observed that “[t]he Commission’s consistent practice, which is in harmony with § 7(c) and its legislative history, is persuasive evidence that Commission disciplinary proceedings, subject to § 7 of the APA, be governed by a preponderance of the evidence standard.”

Interestingly, the Court compared the Vermont Yankee case to the matter before it. In Vermont Yankee, while noting that agencies may grant additional procedural rights in their discretion, the Court stated that section 4 of the APA established the “maximum procedural requirements which Congress was willing to have the courts impose upon agencies in conducting rulemaking procedures.” Thus, while Vermont Yankee involved agency rulemaking and Steadman involved agency adjudication, the same overriding principle applies—agencies normally need only comply with the requirements of the APA to be immune from successful challenge.

Dissenting in Steadman, Justice Powell, joined by Justice Stewart, argued that, because the Investment Company and Investment Advisers Acts were enacted against the common-law background which required that allegations of fraud be proved by clear and

10. Id. at 4177. The Court quoted the following language from the House Report which, in the Court’s view, removed “[a]ny doubt as to the intent of Congress . . . which expressly adopted a preponderance of the evidence standard:"

“[W]here a party having the burden of proceeding has come forward with a prima facie and substantial case, he will prevail unless his evidence is discredited or rebutted. In any case the agency must decide ‘in accordance with the evidence.’ Where there is evidence pro and con, the agency must weigh it and decide ‘in accordance with the preponderance. In short, these provisions require a conscientious and rational judgment on the whole report in accordance with the proofs adduced.’ H.R. Rep. No. 1930, 79th Cong., 2d Sess. 37 (1946) (emphasis added).

Id.

11. Id. at 4178 (citing In re Cea, 44 S.E.C. 8, 25 (1969); In re Pollisky, 43 S.E.C. 458, 459-60 (1967); In re White, 3 S.E.C. 466, 539-40 (1938)).


13. Id. at 524. In this regard, the Court further stated:

This is not to say necessarily that there are no circumstances which would ever justify a court in overturning agency action because of a failure to employ procedures beyond those required by the statute. But such circumstances, if they exist, are extremely rare.

Even apart from the Administrative Procedure Act this Court has for more than four decades emphasized that the formulation of procedures was basically to be left within the discretion of the agencies to which Congress had confided the responsibility for substantive judgment.

Id.
convincing evidence, Congress did not intend, in enacting the APA subsequent to those Acts, to supplant the then-applicable standard of proof in fraud adjudications. Observing that the SEC's finding of fraud and its imposition of severe penalties have resulted in "serious stigma and deprivation," Justice Powell concluded that "[i]n the absence of any specific demonstration of Congress' purpose, we should not assume that Congress intended the SEC to apply a lower standard of proof than the prevailing common law standard for similar allegations." 14

III. OTHER IMPLICATIONS

Based on Justice Powell's dissent, it may be argued that the clear and convincing standard should apply to SEC injunctive suits and private actions based on fraud. 15 In this regard, the Fifth

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14. 49 U.S.L.W. at 4178 (Powell, J., dissenting). This interpretation is subject to dispute. See text and accompanying notes 24-29, 38-39 infra.

15. See Huddleston v. Herman & MacLean, [Current] Fed. Sec. L. Rep. (CCH) ¶97,919, at 90,665-66 (5th Cir. Mar. 9, 1981) (clear and convincing standard applies in private damage actions brought for alleged violations of § 10(b)). But see SEC v. First Pennsylvania Group of Tex., [Current] Fed. Sec. Law Reps. (CCH) ¶98,004 (5th Cir. May 20, 1981) (preponderance of the evidence is the appropriate standard of proof in SEC civil enforcement action for preliminary injunctive relief under the anti-fraud provisions of the federal securities laws); Miley v. Oppenheimer & Co., 637 F.2d 318, 328 (5th Cir. 1981) (upholding trial court's jury instructions in rule 10b-5 suit which, inter alia, directed the jury to find the facts relevant to damages by a preponderance of the evidence); Mihara v. Dean Witter & Co., 619 F.2d 814, 824-25 (9th Cir. 1980) (in rule 10b-5 action against broker-dealer for churning, court upheld jury instructions requiring that proof of violation be shown by preponderance of the evidence); SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 102 (2d Cir. 1978) (affirming the district court's findings of antifraud violations where the lower court had employed the preponderance of the evidence standard); University Hill Foundation v. Goldman, Sachs & Co., 422 F. Supp. 879, 897 (S.D.N.Y. 1976) (in action brought for alleged violations of §12(2) of Securities Act and §10(b), court apparently used "preponderance of the credible evidence" standard); Ronson Corp. v. Liquifin Aktiengesellschaft, 370 F. Supp. 597, 602 (D.N.J.), aff'd per curiam, 497 F.2d 394 (3rd Cir.), cert. denied, 419 U.S. 870 (1974) ("Under Section 14(e) [an antifraud provision] as in any civil suit, the burden falls upon the plaintiff to demonstrate by a preponderance of the evidence that it is entitled to permanent injunctive relief."); SEC v. Gilbert, 79 F.R.D. 683, 686 (S.D.N.Y. 1978) (in civil action against broker, preponderance standard to be used). See generally SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 355 (1945) (in determining whether instruments sold were "securities" "preponderance of the evidence will establish the case"). See also SEC v. Savoy Indus., Inc., 587 F.2d 1149 (D.C. Cir. 1978), cert. denied sub nom. Zimmerman v. SEC, 440 U.S. 913 (1979), where the Commission brought an injunctive action against Savoy and certain persons that controlled Savoy for violating certain reporting provisions of the federal securities laws by filing misleading and incomplete documents concerning the nature of the control exercised. The court held that Commission injunctive proceedings need be proved by the "preponderance of the evidence":

The principal purpose of this type of injunction is, of course, to deter future violations, and not to punish the violator. Furthermore, an injunction against violation of the reporting provisions does not ipso facto involve a deprivation of livelihood, and, as a practical matter, would not be nearly as extensive an impairment to Zimmerman as a revocation would be to a broker-dealer. The standard of proof is a matter for the judiciary to decide, and we believe that, under the circumstances, it is best to adhere to a preponderance of the evidence standard.

Id. at 1169.
Circuit in a post-Steadman case, Huddleston v. Herman & MacLean, hold that the proper standard of proof in a private action for damages brought for alleged violations of section 10(b) was that of clear and convincing evidence. Observing from the Supreme Court's holding in Ernst & Ernst v. Hochfelder that section 10(b) is an anti-fraud provision, the Fifth Circuit thereupon reasoned that "[t]he traditional burden of proof imposed in cases involving allegations of civil fraud is the 'clear and convincing' evidence standard." The court distinguished Steadman, stating that the Supreme Court's holding was limited to the proper standard of proof in an administrative proceeding.

Although the Fifth Circuit's holding is confined to private damage suits under section 10(b), its rationale could extend to SEC injunctive actions based on fraudulent conduct. Contrary to such reasoning, however, it may be argued that the proper standard of proof in both SEC and private actions in this context should be that of the preponderance of the evidence. As the Commission pointed out in its brief before the Supreme Court in Steadman, a number of jurisdictions in common law fraud cases have applied the preponderance standard, adhering to the view that "there is no sound reason for according special evidentiary benefits to those accused of fraud at

17. Id. at 98,665-66.
20. Id. (**"We conclude that the higher threshold of proof of fraud required in Rule 10b-5 actions mandates that the plaintiffs prove their case under the higher standard of proof." Id. at 90,665-66.**
21. Id. at 90,666 n.19.
22. Id. (**"There is no suggestion in the Supreme Court's Steadman opinion that the holding has any application in the context of a private cause of action brought in district court." (emphasis added)).**
23. See text and accompanying notes 18-20 supra; [Current] Fed. Sec. L. Rep. (CCH) ¶ 97,919, at 90,666 n.19 ("judgment for the plaintiff [in a rule 10b-5 civil fraud action] detracts from the defendant's reputation to a far greater extent than in other civil litigation.").
the expense of those claiming to be their injured victims . . . .”

This standard has also been applied in a number of attorney disbarment proceedings based on the need to protect the public interest rationale. Even more fundamentally, according to the SEC, “imposition of a [preponderance] standard of proof borrowed from inapposite common law cases would undermine the important purposes of the federal securities laws, which Congress enacted to remedy inadequacies in common law protections.”

If necessary in this context, the proper standard of proof in SEC injunctive suits based on fraud can be distinguished from the standard to be applied in private actions. Unlike a private lawsuit, an SEC injunctive action is a statutory proceeding brought under remedial provisions of the federal securities laws and thus is essentially prophylactic in nature: its purpose is to protect investors and the integrity of the marketplace against future harm, and not to punish the alleged wrongdoer. Moreover, if the clear and convincing standard were

25. Brief of the SEC, note 24 supra, at 32-33, relying on cases cited note 24 supra.


27. Brief of the SEC, note 24 supra, at 35.


Another argument raised by the Commission was that the use of the clear and convincing standard has its roots in a historical setting that is not relevant in a securities fraud context. The Commission stated:

While decisions in non-statutory fraud cases involving private parties have sometimes employed a clear and convincing evidence standard, particularly when certain types of equitable relief have been sought, the use of the higher standard generally has rested on historical considerations that have no pertinence here. The practice of requiring a more stringent standard of proof appears to have arisen in actions in which the chancellor was requested to grant relief on claims that were unenforceable at law for failure to comply with the Statute of Frauds, or the Statute of Wills, and was subsequently applied in actions seeking to set aside or alter the terms of written instruments. A higher standard of proof was employed in such cases because they were believed to involve special dangers that claims might be fabricated. The concern of the courts in these circumstances was the need to protect the sanctity of written instruments and the reliance placed upon such documents.

Brief of the SEC, note 24 supra, at 34 (citations omitted).
to apply in this context, an anomaly would be created between SEC administrative disciplinary proceedings and injunctive actions. Those persons and entities subject to the Commission's disciplinary authority would have differing standards of proof apply to identical conduct, depending wholly upon whether the SEC elected to bring suit administratively or in the federal courts. Indeed, it is arguable that under such a dual standard, the Commission could proceed administratively, even after it had failed in its civil injunctive action, because of the lower standard of proof applicable in such administrative proceedings. For these reasons, a dual standard approach makes little sense. It would not only unduly burden the Commission's objectives of maintaining investor protection and the integrity of the marketplace but may also wreak havoc upon those who are subject to the SEC's administrative disciplinary processes.

Regarding other matters relating to Steadman's scope, the decision, based on an interpretation of the APA, apparently has government-wide application. Moreover, the decision strongly implies that the proper standard of proof in other types of SEC administrative proceedings is also the preponderance standard. Thus, this standard evidently applies in other Commission disciplinary actions, such as against broker-dealers and associated persons pursuant to section 15(b) of the Exchange Act and against professionals under rule 2(e) of the Commission's Rules of Practice. Indeed, in the Carter Johnson case, the Commission, relying on Steadman, employed the preponderance standard in a rule 2(e) proceeding.


Further, it is arguable that, by having the authority to bar such regulated persons from their occupations, the Commission has the potential to inflict more severe sanctions in an administrative proceeding than if it were to proceed in a civil injunctive setting. This factor represents an additional reason in support of the use of the preponderance standard in SEC injunctive actions.

30. Because the Court relied in part on the Commission's long-standing practice of employing a preponderance of the evidence standard, there may be some question whether the same standard would hold true to other agencies which have no such long-standing practice. As stated by one source, however, "the basic rationale of the opinion would seem to dictate that preponderance is the standard to be applied in any administrative proceeding to which Section 7(e) of the Administrative Procedure Act applies." Stillman & Mills, Steadman: Supreme Court Rejects Clear and Convincing Standard, Legal Times (Wash.), March 9, 1981, at 15, 16, col. 1.

31. In re Carter Johnson, Fed. SEC. L. Rep. (CCH) Special Report, No. 903, at 2 n.3 (S.E.C. Feb. 28, 1981), 22 SEC Docket 292, 293 n.3 (March 17, 1981) (in Steadman "the Supreme Court decided ... that the standard of proof applicable in administrative proceedings of this nature is the 'preponderance-of-the-evidence,' rather
IV. Steadman's Significance

Whether the standard of proof utilized in SEC administrative proceedings, which generally "serves to allocate the risk of error between the litigants," 82 is substantively significant or is "much ado about nothing" remains a question that may never be definitively answered. In this regard, the Court's decision in Aaron v. SEC, 83 than the 'clear and convincing evidence' standard, and we have therefore applied such standard in our review of these proceedings.

82. On this point, the Commission stated in its Steadman brief:

As this Court observed in Addington v. Texas, 441 U.S. 418, 423 (1979), the standard of proof utilized in a trial-type proceeding "serves to allocate the risk of error between the litigants." Under the traditional preponderance of the evidence standard, the parties bear roughly the same risk of error.

A standard of proof more stringent than the traditional preponderance standard protects the favored party against an erroneous decision that is adverse to him, but increases the overall likelihood of an erroneous decision. This special measure of protection at the cost of increased error is tolerable only "when the possible injury to the individual is significantly greater than any possible harm to the state." Id. at 427. Where, as here, the interests of the fiduciary do not outweigh the interests of the class of investors that the government seeks to protect, there is no valid reason for adopting a standard of proof that would shift the risk of error from the fiduciary and expose his beneficiaries to an increased number of decisional errors.

Brief of the SEC, note 24 supra, at 16. See cases discussed note 3 supra.

83. 100 S. Ct. 1945 (1980). In Aaron, the Court held that the SEC must prove scienter as an element of a civil enforcement action in order to enjoin violations of § 10(b) of the Exchange Act and rule 10b-5 prescribed thereunder, and § 17(a) (1) of the Securities Act, but need not prove scienter under § 17(a) (2) or § 17(a) (3).

With respect to the issuance of an injunction "upon a proper showing" for violation of § 17(a) (2) or § 17(a) (3), which may be violated by negligent conduct, the Court pointed out that "nothing on the face of § 20(b) [of the 1933 Act] or § 21(d) [of the 1934 Act] purports to impose an independent requirement of scienter." Id. at 1958. In so holding, however, the Court stated that in an SEC action under § 17(a) (2) and § 17(a) (3), "the degree of intentional wrongdoing evident in a defendant's past conduct" is "[a]n important factor" in determining whether the Commission has "establish[ed] a sufficient evidentiary predicate to show that such future violation may occur." Id. In this regard, the presence or lack of scienter, the Court concluded, is "one of the aggravating or mitigating factors to be taken into account" in the court's exercise of its equitable jurisdiction. Id. In a concurring opinion, Chief Justice Burger deviated from the majority's rationale in this respect, asserting that the SEC "will almost always" be required to show that the defendant's past conduct was more culpable than negligence. The Chief Justice concluded that "[a]n injunction is a drastic remedy, not a mild prophylactic, and should not be obtained against one acting in good faith." Id. at 1958-59.

Some commentators contend that the Aaron Court's language, even if viewed apart from the Chief Justice's concurring opinion, in all practicality, requires proof of scienter in SEC injunctive actions under any section of the securities acts. See commentators referred to in Huffman, Aaron Resticts SEC Enforcement, Legal Times (Wash.) p. 2 (June 9, 1980); Marcus, SEC Sees Nothing Fatal in Curb on Fraud Writs, National Law Journal p. 3 (June 16, 1980). This assertion, however, may be an overstatement. As stated in a recent Ninth Circuit case, SEC v. Murphy, 626 F.2d 633 (9th Cir. 1980), although concluding that the defendant "hid, at the least, acted recklessly in violating the registration provision," id. at 655, the court's language supports the proposition that conduct not involving scienter may be sufficient culpability for the granting of injunctive relief:

In the present proceeding, the totality of the circumstances strongly suggests the need for an injunction. Murphy stated that he took all precautions he thought reasonable to keep from violating the registration requirements. Nevertheless, the court found that he did violate them. The fact that he did violates the requirements once when he did not intend to do so is sufficient
which dealt with the requisite state of mind in certain SEC injunctive suits, is analogous: The effect upon the SEC, if any, in being required to prove scienter in procuring injunctive relief in certain cases might have foreshadowed the increased difficulty that the Commission would have experienced in utilizing a clear and convincing standard in administrative proceedings, had Steadman so ruled.

It bears emphasis, however, that Steadman has much broader application than to SEC disciplinary proceedings. It could have been very well the case that the Court refused, as it did in Vermont Yankee, to leave open the door to widespread challenges to procedures employed by federal agencies. A conclusion that a clear and convincing standard was required in SEC administrative proceedings may well have prompted challenges to the procedures utilized by other government agencies, both in regard to the standard of proof issue and to other issues that were waiting to surface. This occurrence would have left the federal agencies "with time to do little else." 34 The portent

to justify the conclusion that he might do so again, even if the court believed he was sincere in his protestations to the contrary. Moreover, his continued insistence that he has done nothing wrong indicates that he may commit similar errors in the future, particularly since he has not expressed an intention to cease dealing in limited partnerships.

Id. at 656. And, as stated by this commentator:

It is arguable that the majority merely stated that the presence of scienter is an important factor for a court to weigh in determining whether to grant the Commission's request for injunctive relief. The absence of scienter may not preclude the granting of such relief where the applicable statutory provision requires only negligent culpability. Indeed, where a defendant has committed prior violations, where his carelessness is egregious, where public investors have been severely injured, or where the defendant's occupation increases the probability of future violations, a court considering the totality of the circumstances, may order injunctive relief.

Steinberg, SEC and Other Permanent Injunctions: Standards for Their Imposition, Modification, and Dissolution, 66 CORNELL L. REV. 27, 36 (1980).

34. See 49 U.S.L.W. at 4178; Vermont Yankee Nuclear Power Corp. v. National Resources Defense Council, Inc., 435 U.S. 519, 524-25 (1978). See also FTC v. Standard Oil Co. of Cal., 49 U.S.L.W. 4054 (Dec. 15, 1980) (the FTC's issuance of a complaint was not final agency action under § 10(e) of the APA and, accordingly, was not judicially reviewable before the conclusion of the administrative adjudication). As this author has noted, in the Freedom of Information Act context, despite an agency's due diligence and its employment of all appropriate and available personnel, the sheer volume of requests may render the agency incapable of complying with the statutory time periods:

The more logical approach ... is to recognize that an agency has important functions assigned to it other than the processing of informational requests. In the case of the FBI, it is uncontroversible that this agency has vital law enforcement duties to perform. To interpret the existence of exceptional circumstances to signify the deployment of all personnel to complete the review and deliberation process within statutory time limits would leave the FBI with time to do little else. Under such a construction, the FBI would be incapable of performing its law enforcement obligations in a satisfactory manner.

Steinberg, The 1974 Amendments to the Freedom of Information Act: The Safety Valve Provision Section 552(a)(6)(C) Excusing Agency Compliance With Statutory Time Limits—A Proposed Interpretation, 52 NOTRE DAME LAW. 235, 243-44 (1976). This rationale is also applicable in suits seeking to modify or dissolve SEC or other government injunctions. See Steinberg, note 33 supra, at 62-63.
of such an occurrence may have induced the Court to hold that, so long as the APA is complied with, agency procedures are normally immune from successful challenge.

Steadman, moreover, was a victory for the SEC. After a seemingly long recess, the Court once again characterized a long-standing practice of the Commission’s as “persuasive authority” indicative of Congress’ intent.\textsuperscript{35} Also, in Steadman, the Court adhered to its apparently established jurisprudential approach of premising its decision on the statutory language and legislative history, and declining to assess the “wisdom” or “policy” of Congress’ rationale.\textsuperscript{36} Under such an approach, the Commission showed, as it did in Rubin \textit{v. United States},\textsuperscript{37} that it can emerge victorious. Indeed, perhaps one

\textsuperscript{35} 49 U.S.L.W. at 4178. In this regard, the Court stated that the Commission’s practice of employing the preponderance standard was consistent with the statute and legislative history. \textit{But see} International Bhd. of Teamsters \textit{v. Daniel}, 439 U.S. 551 (1979); SEC \textit{v. Sloan}, 436 U.S. 103 (1978).

\textsuperscript{36} Thus, as the Steadman Court stated:

Because the task of determining the appropriate standard of proof in the instant case is one of discerning Congressional intent, many of petitioner’s arguments are simply inapposite. He contends, for example, that as a matter of policy, the potentially severe consequences to a respondent in a Commission proceeding involving allegations of fraud demand that his burden of risk of erroneous factfinding should be reduced by requiring the Commission to prove violations of the antifraud provisions of the securities laws by clear and convincing evidence. This argument overlooks, however, Congress’ traditional powers . . . to prescribe standards of proof. . . . \textit{Vance v. Terrazas}, 444 U.S. 252, 265 (1980). It is not for this Court to determine the wisdom of Congress’ prescription.


37. 49 U.S.L.W. 4103 (U.S. 1981) (pledge of stock as collateral for a loan is an “offer or sale” of a security under §17(a) of the Securities Act). The Court reasoned that the procurement of a loan secured by a pledge of stock involves, according to the definition of the terms “offer” and “sale” contained in §2(3) of the Securities Act, a “disposition of . . . [an] interest in a security, for value.” Thus, “[a]lthough pledges transfer less than absolute title, the interest thus transferred nonetheless is an interest in a security.” \textit{Id.} at 4104.

Justice Blackmun, concurring in the judgment, reasoned that:

While I agree that a pledge of stock to a bank as collateral for a loan is an “offer or sale” of a security within the meaning of §17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a), I reach that conclusion by a slightly different route than does the Court. The Court holds that a pledge confers an interest in a security, and that therefore a pledge of shares of stock as collateral for a loan constitutes a “disposition of . . . [an] interest in a security for value” within the meaning of §2(3) of the Act, 15 U.S.C. §77b(3). I would hold simply that a pledge of stock as collateral is a type of disposition within the meaning of §2(3).

\textit{Id.} at 4105 (Blackmun, J., concurring in the judgment) (citations omitted).

Justice Blackmun’s concurrence is significant because the definition of “sale” contained in §3(a)(14) of the Exchange Act includes “any contract to sell or otherwise dispose of” a security. Hence, under Justice Blackmun’s concurrence, this definition would encompass pledges in suits brought for alleged violations of §10(b) of the Exchange Act. The majority’s language, on the other hand, leaves the
of the more curious aspects of Steadman is that it was Justice Powell, who coined the Cort v. Ash private right implication doctrine as judicial legislation "not faithful to constitutional principles," 38 who dissented in part based on a policy rationale unrelated to congressional intent. 39 Interestingly, Justice Powell was able to persuade only one other member, Justice Stewart, to join in such an analysis.

V. Conclusion

Steadman thus represents a victory for the federal regulatory agencies in general and the SEC in particular. The decision's significance to the SEC, however, should not be overly exaggerated. Steadman, like prior Supreme Court decisions, was premised on construing the pertinent statutory language and legislative history. While the SEC can be successful under such a rationale, it is by no means

"pledge" issue open under §10(b). Compare Manisach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023, 1030 (6th Cir. 1979), and Mallis v. FDIC, 568 F.2d 824, 828-30 (2d Cir. 1977), cert. dismissed, 435 U.S. 381,reh. denied, 436 U.S. 915 (1978) (pledge is a sale under §10(b)), with Lincoln Nat'l Bank v. Herber, 604 F.2d 1038, 1040-44 (7th Cir. 1979), National Bank of Commerce v. All American Assurance Co., 583 F.2d 1295, 1298-1300 (5th Cir. 1978), Reid v. Hughes, 578 F.2d 634, 638 (5th Cir. 1978), and McClure v. First Nat'l Bank, 497 F.2d 490, 495-96 (5th Cir. 1974), cert. denied, 420 U.S. 930 (1975) (pledge is not a sale under §10(b)).

38. Cannon v. University of Chicago, 441 U.S. 677, 731 (1979) (Powell, J., dissenting). See Steinberg, Implied Private Rights of Action Under Federal Law, 55 Notre Dame Law. 33, 40 (1979) ("Although there may well exist strong policy reasons why Congress rather than the federal judiciary should be the proper branch to authorize federal actions, Justice Powell's assertion that the courts are pursuing an unconstitutional course is premised on unduly strict notions of judicial restraint."). In Cort v. Ash, the Court enunciated a four-prong test for determining the existence of an implied private right of action under a federal statute:

First, is the plaintiff "one of the class for whose especial benefit the statute was enacted.... Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?


39. 49 U.S.L.W. at 4178 (Powell, J., dissenting) (although the case did not involve any constitutional issue (see id., at 4176 n.15). Justice Powell stated: "With all respect, it seems to me that the Court's decision today lacks the sensitivity that
assured of victory. Thus, unlike United States v. Naftalin, Steadman does not offer a welcome respite to those who fondly remember the Court's earlier expansionistic decisions in the securities area. Nor does Steadman, in any way, signify that the Court, however momentarily, may have embraced the proposition, as in earlier days, that the securities laws are designed to prevent fraudulent conduct of any kind, however novel or unique. In short, Steadman comports traditionally has marked our review of the Government's imposition upon citizens of severe penalties and permanent stigma.”). In all fairness, however, Justice Powell also dissented on the premise that the APA was simply inapplicable to SEC disciplinary proceedings in regard to the standard of proof.

40. 441 U.S. 768 (1979). In Naftalin, the Supreme Court dealt with the construction of §17(a) of the Securities Act in the context of a criminal prosecution. In upholding Naftalin's conviction, the Court concluded that the protection of §17 (a)(1) extends beyond actual purchasers and investors, that the "in" language of §17(a) may as encompassing as the "in connection with" language of §10(b), and that §17(a) applies to aftermarket trading frauds. A question remaining after Naftalin is whether §17(a) provides a private right of action for damages. See Newman v. Prior, 518 F.2d 97, 99 (4th Cir. 1975) (§17(a) provides implied private damages action to protect investors from fraudulent sale of securities); Democ v. Dean Witter & Co., 476 F. Supp. 275 (D. Alaska 1979) (private right of action under §17(a)(2), but not under §17(a)(1) or §17(a)(2)); In re Gap Stores Litigation, 457 F. Supp. 1135, 1142 (N.D. Cal. 1978) (private right of action implied under §17(a)); Valles Salgado v. Piedmont Capital Corp., 452 F. Supp. 853, 857-58 (D.P.R. 1978) (§17(a) provides implied private damages remedy for fraudulent purchase of mutual fund shares). But see Woods v. Homes & Structures of Pittsburg, Kansas, 489 F. Supp. 1270, 1284-88 (D. Kan. 1980) ("Plaintiffs will not be permitted to circumvent the restrictions of the 1934 Act and the express remedy of Section 12(2) of the 1933 Act via an implied Section 17(a) action."); McFarland v. Memorex Corp., 493 F. Supp. 631 (N.D. Cal. 1980) (no implied right of action under §17(a) based on application of Redington and Lewis); In re New York City Municipal Sec. Litigation, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) §97,258 (S.D.N.Y. Jan. 29, 1980) (no implied private right of action under §17(a) based on legislative history and construction of §§11 and 12(2)); Dyer v. Eastern Trust & Banking Co., 336 F. Supp. 890, 903-05 (D. Me. 1971) (review of legislative history and statutory construction makes clear §17(a) not intended to provide private damage remedy).

Even if no private right of action is inferred under §17(a), Naftalin represents a potent weapon in the government's arsenal for enforcement of the antifraud provisions. This is particularly true in light of Aaron v. SEC, 100 S. Ct. 1945 (1980), which held that the SEC need not prove scienter in injunctive actions brought for violations of §17(a)(2) or §17(a)(3). For further discussion on Naftalin, see Steinberg, Section 17(a) of the Securities Act of 1933 After Naftalin and Redington, 68 Geo. L.J. 163 (1979).

41. See, e.g., Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) (relaxing the common-law reliance requirement in cases of nondisclosure under §10(b)); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971) (recognizing implied right of action under §10(b); applying that provision where there was an arguably tenuous connection between the securities transaction and the fraudulent activity); SEC v. National Sec., Inc., 393 U.S. 453 (1969) (recognizing SEC's authority to regulate securities activities of insurance companies); J.I. Case Co. v. Borak, 377 U.S. 426 (1964) (recognizing implied right of action under §14(a) of Exchange Act); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) (upholding requirement under Investment Advisers Act of 1940 that registered investment adviser disclose personal financial interest in securities recommended to clients).

42. Such propositions were advanced shortly after Naftalin was decided. See Pickholz & Dorfman, Fraud Standard Illustrated 'Naftalin' Aids Plaintiffs, Legal Times (Wash.), May 28, 1979, at 16, col. 1; 'Naftalin' Viewed as Significant Win by SEC Attorneys, id. at 1, col. 1. See generally cases cited note 41 supra.
with the prior linguistic analysis of the Burger Court. The decision is significant, however, in exemplifying that the SEC is on track in deciphering this new approach and may prove in the foreseeable future a far tougher competitor in the high Court than it has in the recent past.

43. See, e.g., cases cited note 36 supra. See also Stillman & Mills, note 30 supra, where the authors contend:

Although the *Hochfelder* and *Santa Fe Industries* cases, and other decisions during the past several years, have been viewed as reflecting a trend by the Supreme Court to restrict the scope of the federal securities laws, the recent decisions in *Steadman*, *Rubin*, and *Aaron* suggest a different explanation. They indicate that the Court is simply utilizing a method of statutory construction that relies primarily on the statutory language and leaves matters of policy to be decided by Congress. During the latter part of the 1970's this approach resulted in decisions where the plaintiffs lost. The recent decisions, however, indicate that the Court is receptive to arguments that favor the plaintiff in securities cases when the arguments do not rest largely on policy considerations.

Another factor to be considered in analyzing the recent decisions is that they involved governmental, rather than private, actions. A number of the earlier decisions restricting the scope of the securities laws, including *Hochfelder* and *Santa Fe Industries*, involved private actions. Over the past several years the Supreme Court has indicated that it does not view private rights of action under the federal securities laws as favorably as it previously regarded them. *Compare Blue Chip Stamps v. Manor Drug Stores* with *J.I. Case Co. v. Borak*. The recent rulings in favor of the Commission's position in *Steadman*, *Rubin* and *Aaron* may reflect the Court's willingness to accord greater weight to the interests of investors in proceedings brought by the Government.

*Id.* at 23, cols. 2-3.