10-1979

Aaron v. Securities and Exchange Commission (SEC)

Lewis F. Powell Jr.

Grant

Presents Q left open in Ernst & Ernst: whether scienter is required ~~in~~ in an injunctive proceedings under §17a of '33 act & §10b of '34 Act?

SG urges grant in view of importance of issue - & extent of litigation

PRELIMINARY MEMORANDUM

October 12, 1979 Conference
List 1, Sheet 1

No. 79-66

AARON

v.

SECURITIES & EXCHANGE COMMISSION

Cert to CA 2
(Anderson, Feinberg, & Timbers)

Federal/Civil

Timely

1. SUMMARY: This case raises the questions whether Sec. 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), and Sec. 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b)(and Rule 10b-5 promulgated thereunder) require proof of scienter in an injunctive proceeding brought by the Securities & Exchange Commission.

2. FACTS: In February 1976 the SEC filed a complaint against eight defendants, including petr, alleging inter alia violations of the anti-fraud provisions of Sec. 17(a) of the Securities Act of 1933, Sec. 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 in

Grant: there is a conflict on the important question left open in Hochfelder. CJ

connection with the offer and sale of common stock of Lawn-A-Mat Chemical & Equipment Corp. (Lawn-A-Mat). (The applicable statutory provisions and regulation are included in the appendix attached hereto.) Petr, who had supervisory responsibility over the employees of a broker-dealer firm registered with the Commission, allegedly violated the aider and abetter provisions of the Securities Acts in that he knew or should have known the employees of the broker-dealer firm were making materially false and misleading representations in the offer and sale of Lawn-A-Mat stock, but failed to take steps to prevent or terminate the fraudulent activity. Following a three-day evidentiary hearing, the DC found that petr had violated Sec. 17(a), Sec. 10(b), and Rule 10b-5 ; it enjoined him from future violations of those provisions. The CA affirmed.

3. CA DECISION: In reaching its decision, the CA held that neither Sec. 17(a) nor Sec. 10(b) requires a showing of scienter when the government brings enforcement actions to enjoin violations of those sections. The CA first examined Sec. 10(b) in light of Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), which held that proof of scienter is a necessary element in a private damage action under Sec. 10(b). It noted that Ernst explicitly left open the question whether scienter would be required in future injunction actions. 425 U.S. at 194 n. 12. It concluded that allegations and proof of negligence alone will suffice for injunctive relief under that Section.

The CA examined the factors relied on by this Court in Hochfelder: (1) the language of Sec. 10(b); (2) the legislative history of the 1934 Act; and (3) the relationship of Sec. 10(b) to the other express civil remedies and the effect of a scienter requirement on the overall statutory scheme of the securities laws. The CA rejected the contention that Hochfelder's analysis of the language of Sec. 10(b) should apply

with equal force to the question whether scienter is a requisite element in a government injunction action. After noting that different courts have construed the language of Sec. 10(b) differently, it examined the legislative history and purpose of the section. It reasoned that (1) a negligence standard should be applied in a government enforcement action because such actions are brought to provide maximum protection for the investing public, as contrasted with the purpose of private damage actions which are brought to obtain monetary relief for individual investors, (2) Sec. 21(d) indicates that scienter was not intended to be required in SEC injunction actions [1] and (3) the rejection of a scienter requirement for SEC injunction actions is consistent with the overall enforcement scheme of the securities acts.

The CA then noted that it follows a fortiori from its holding with respect to the scienter requirement of Sec. 10(b) that scienter is not a requisite element of a government enforcement action to enjoin violations of Sec. 17(a). After observing that other circuits are divided on the issue whether Hochfelder should apply to actions brought under Sec. 17(a), the CA 2 noted that it had previously determined unequivocally that scienter is not required in such an action as a result of the absence

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[1] "The CA also noted that when Sec. 21(d) was replaced by Sec. 21(e) in 1975, Congress expressly indicated its approval of the approach taken by the CA 2 in not requiring a showing of scienter for injunction actions brought under Sec. 10(b): 'Private actions frequently will involve more parties and more issues than the Commission's enforcement action, thus greatly increasing the need for extensive pre-trial discovery. In particular, issues related to matters of damages, such as scienter, causation, and the extent of damages are elements not required to be demonstrated in a Commission injunctive action.'" (Citation omitted)(Emphasis in original). S. R. Rep. No. 75, 94th Cong., 1st Sess. 76 (1975).

in Sec. 17(a) of any terminology comparable to the words "manipulative or deception" "device" or "contrivance" which the court found persuasive in Hochfelder. SEC v. Coven, 581 F.2d 1020, 1026-28 (2d Cir. 1078).

4. CONTENTIONS: Petr contends the CA's holding that scienter is not required under Sec. 10(b) conflicts with the interpretation of that section adopted by the CA 5 in SEC v. Blatt, 583 F.2d 1325, 1333 (5th Cir. 1978) and that its interpretation of Sec. 17(a) conflicts with the CA 7's interpretation of that section in Sanders v. John Nuveen & Co., 554 F.2d 790, 795-796 (7th Cir. 1977). Petr notes that here the CA 2 found the language of Sec. 10(b) alone is not determinative of the issue and thus resort to legislative history and purpose is proper. The CA 2 also held that the policy considerations underlying the securities acts clearly reflect that a negligence standard should be applied in government enforcement actions. By contrast, the CA 5 on Blatt held that discussion of the language of Sec. 10(b) in Hochfelder conclusively demonstrates that scienter is a necessary element in government enforcement actions. It further stated that the language of the section was sufficiently clear to be controlling notwithstanding considerations of public policy. The conflict between the CA 2 and CA 7 with respect to the appropriate interpretation of Sec. 17(a), according to petr, is equally apparent.

Petr next contends the decision below raises significant and recurring problems. These are: (1) Does this Court's analysis and holding in Hochfelder under Sec. 10(b) and Rule 10b-5 apply to SEC injunctive proceedings? (2) Are the language and history of Sec. 10(b) dispositive of the issue, or do arguments of policy and purpose control? and (3) Should Sec. 17(a) be read in harmony with Hochfelder?

5. DISCUSSION: The issues presented are certworthy and the case

suitable for review. In his response, the SG recommends this Court grant review in light of the importance of the issues, the extraordinary amount of time expended in litigating them, and the disagreement among the lower courts.

There is a response.

10/3/79 Asperger Op in petn.

CMS

APPENDIX

Section 17(a) of the Securities Act of 1933:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Section 10(b) of the Securities Exchange Act of 1934:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(b) To use or employ, in connection with the purchase of sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange.

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

October 12, 1979

Court .....
Argued ....., *19*...
Submitted ....., *19*...

Voted on ....., *19*...
Assigned ....., *19*...
Announced ....., *19*...

No. 79-66

AARON

vs.

SEC

Grant

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING
		G	D	N	POST	DIS	AFF	REV	AFF	G	D		
Burger, Ch. J.			✓										
Brennan, J.		✓											
Stewart, J.		✓											
White, J.		✓											
Marshall, J.			✓										
Blackmun, J.		✓											
Powell, J.		✓											
Rehnquist, J.			✓										
Stevens, J.		✓											

Reviewed 2/15 The issue is whether in an injunctive action under 10b of the '34 Act & 17(a) of '33 Act, by the SEC, it must prove scienter.

Ernst & Ernst: Tho it left open the Q of scienter, the language, history of 10b & analysis of E&E support view that scienter is required in an injunctive suit by SEC. Such a suit, & an injunction, are punitive & can impose severe stigma & other penalties.

DOS

Ask what penalties

BENCH MEMORANDUM

TO: Mr. Justice Powell But David thinks the different language of 17(a) (the scienter implying words of 10b are absent), plus history probably should be read as not requiring scienter. § 17a applies, however, only to sellers of securities & thus would be more limited in application than 10b that applies to buyers as well,

FROM: David

DATE: Feb. 15, 1980

RE: No. 79-66, Aaron v. SEC

17a of '33 Act applies only to Sellers

The question in this interesting case is whether the SEC need prove scienter in a proceeding for an injunction under § 10(b) of the 1934 Act and §17(a) of the 1933 Act. Some of the difficulty with the case is that it presents the question with respect to both statutory provisions, so any answer must harmonize the two. This memo will examine the language and legislative history of each section, in turn. David, would remand

I

In my view, your opinion for the Court in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), should control the disposition of this case with respect to § 10(b) of the 1934 Act. That opinion expressly reserved the question presented here. Id., at 194 n.12. Hochfelder focused on the statute's use of "manipulative or deceptive device or contrivance" as reflecting Congress' intent to require scienter to make out a violation of the provision. The opinion also drew support for that position from the admittedly sketchy

Yes

legislative history of § 10(b). There is no reason to depart now from the analysis in Hochfelder.

The SEC, however, attempts to distinguish this case, arguing that Hochfelder involved a damage suit under an implied right of action, while this suit is for an injunction under § 21(d) of the 1934 Act. The SEC relies heavily on Justice Goldberg's opinion in SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963), which involved an equitable action under the Investment Advisers Act of 1940. The Court in Capital Gains ruled that the Commission did not have to establish intent to deceive in order to obtain an injunction compelling a registered investment adviser to disclose to his clients the fact that he had just purchased shares in the corporation that he was touting to the clients. The opinion quotes a treatise for the proposition that "'Fraud has a broader meaning in equity [than at law] and intention to defraud or to misrepresent is not a necessary element.'" Id., at 193. The SEC argues in this case for a similar distinction between actions at law and those in equity.

I believe that Capital Gains is distinguishable from the instant case. The statutory provision in Capital Gains -- § 206 of the Investment Advisers Act -- banned "any . . . practice . . . which operates . . . as a fraud or deceit upon any client or prospective client." This language contrasts fairly sharply with the terms of § 10(b), especially in the Investment Advisers Act's focus on practices that "operate" as a fraud. In addition, Capital Gains interprets the legislative history of the Investment Advisers Act to support its interpretation, while Hochfelder has already parsed the record of § 10(b) to impose a scienter requirement.

The SEC also presents policy considerations on its behalf. Of course, Hochfelder held that there is no reason to look at policy when the language and statutory history are clear. In any event, the Commission stresses the broad remedial purposes behind the 1934 Act and the different nature of injunctive remedies as opposed to damages liability that was at issue in Hochfelder. Although there may be some superficial appeal to the SEC's argument here, it seems fatuous at this point in our history to view injunctive proceedings under the securities laws as anything other than punitive. There can be no doubt that protection of the public is a substantial purpose behind such suits. Similarly, however, there is no doubt that injunctive proceedings have serious negative effects on the targets of the injunctions. The amicus brief for the Securities Industry Association points out that under § 15(b) of the 1934 Act, administrative sanctions may be imposed on a broker-dealer if either (1) he has willfully violated the securities laws, or (2) an injunction has been entered against him. 15 U.S.C. § 78o(b). Amicus argues that unless scienter is required for injunctive proceedings, § 15(b) sanctions may be levied against broker-dealers without any showing of willful misconduct. This, amicus concludes with some force, would violate the clear intent behind § 15(b) that it only apply to intentional wrongdoing.

CA2 relied in substantial part on the amendment of § 21(d) of the 1934 Act in 1975. 15 U.S.C. § 78u(d). The provision authorizes an injunction "[w]henever it shall appear . . . that a person is engaged or is about to engage in acts or practices constituting a violation of this chapter. . . ." When it was revised

in 1975, the Senate Report contrasted injunctive proceedings with damage actions: "In particular, issues related to matters of damages, such as scienter, causation and the extent of damages, are elements not required to be demonstrated in a Commission injunctive action." S. Rep. No. 75, 94th Cong., 1st Sess. 76 (1975) (emphasis in original). The CA found this statement a compelling indication that Congress placed no intent requirement in § 10(b) injunctive proceedings. I disagree. Section 21(d) states that an injunction is available to stop "acts or practices constituting a violation of this chapter." It is a procedural provision, not a substantive one. Thus, unless the challenged acts are independent violations of the substantive securities law, gratuitous remarks in the legislative history of a revision of a procedural provision cannot establish a different standard for finding a violation.

§ 21(d) is procedural

II.

The analysis of § 17(a) of the 1933 Act seems more difficult to me. The language of the statute states:

> "It shall be unlawful for any person in the offer or sale of any securities . . . ,
>
> "(1) to employ any device, scheme or artifice to defraud, or
>
> "(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. § 77q(a).

The analysis of Hochfelder would seem to apply to § 17(a)(1), which uses the key terms "device, scheme or artifice to defraud." Those terms, in 10b clearly convey the idea of scienter. At a somewhat lower level of certainty, § 17(a)(2) might be read in a similar way. The act of "obtain[ing]" money might be seen to include an element of intent, although I must concede the provision might also be interpreted to include negligent as well as intentional acts. With respect to § 17(a)(3), however, there is no doubt in my mind: The language clearly reaches negligent as well as intentional misconduct. Unfortunately, neither the CA nor the DC specified whether the petr in this case had violated a particular subsection of § 17(a), so there is no way of pinpointing the provision in dispute here.

There is a fairly strong basis for reading the subdivisions at issue here as independent provisions. In United States v. Naftalin, 441 U.S. 768 (1979), this Court refused to read a requirement in § 17(a)(3) back into § 17(a)(1):

"The short answer is that Congress did not write the satute that way. Indeed, the fact that it did not provides strong affirmative evidence that while impact upon a purchaser may be relevant to prosecutions brought under § 17(a)(3), it is not required for those brought under § 17(a)(1). As is indicated by the use of an infinitive to introduce each of the three subsections, and the use of the conjunction 'or' at the end of the first two, each

subsection proscribes a distinct category of misconduct. Each succeeding prohibition is meant to cover additional kinds of illegalities -- not to narrow the reach of the prior sections." Id., at 773-774 (footnote omitted).

There is a spirited dispute in the briefs over the significance of the deletion of the word "wilfully" from the final version of § 17(a). Primarily for the reasons offered by the amicus brief of the Securities Industry Association at pp. 17-18, I was not especially impressed with the significance of that deletion. Nevertheless, I do believe that there is no basis for reading a scienter requirement into the language of § 17(a)(3). Consequently, I believe this Court either (1) would have to determine whether the facts of the case make out a violation of that provision [the less-preferred course], or (2) remand for that determination by the DC [my preferred course].

Possible course of action

I have not had time to reflect fully on the impact that such a reading of § 17(a)(3) will have. Clearly, the SEC would then pitch much of its enforcement effort toward that statute, but the provision is limited to those selling securities, which is one of the reasons why § 10(b) was added in 1934. As a result, a certain asymmetry of enforcement policy would develop, where negligent fraud by sellers of securities would be punishable while negligent fraud by buyers would not. This result has some intuitive appeal, since there is a stronger "fiduciary"-type relationship between a professional securities seller and the public. In any event, Congress can always change the statute.

Yes

David

79-66 Aaron v. SEC Argued 2/25/80

Q Is "scienter" required in an injunctive proceedings under 17a of 33 Act & 10b of 34 Act.

Follick (Petr)

Injunctive relief is not "mildly" [struck out] punitive.

Ferrara (for SEC)

Fact that an unfair act has been committed is not basis for injunction. There must be a likelihood of continuation of unfair practice.

(P.S. noted that 10b words were purpose or intent words - not effects words)

Tries - as he must - to distinguish Ernst & Ernst.

This is civil - not criminal - contempt.

DC found that Δ knew or had reason to know what subordinates were doing - thus had acted "knowingly". It found that under either a negligent or scienter standard, Δ had violated Acts.

CA 2 ~~only~~ found that a finding of negligence was sufficient & it need not find scienter

→ / (CJ asked if DC's judg. - finding scienter - could not be affirmed on that basis

lead, the Commission would add a gloss to the operative language of the statute quite different from its commonly accepted meaning. See, *e. g.*, *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U. S. 607, 617–618 (1944).[19] The argument simply ignores the use of the words "manipulative," "device," and "contrivance"—terms that make unmistakable a congressional intent to proscribe a type of conduct quite different from negligence.[20] Use of the word "manipulative" is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.[21]

In addition to relying upon the Commission's argument with respect to the operative language of the stat-

[19] "To let general words draw nourishment from their purpose is one thing. To draw on some unexpressed spirit outside the bounds of the normal meaning of words is quite another. . . . After all, legislation when not expressed in technical terms is addressed to the common run of men and is therefore to be understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him." *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U. S., at 617–618. See Frankfurter, Some Reflections on the Reading of Statutes, 47 Col. L. Rev. 527, 536–537 (1947).

[20] Webster's International Dictionary (2d ed. 1934) defines "device" as "[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice," and "contrivance" in pertinent part as "[a] thing contrived or used in contriving; a scheme, plan, or artifice." In turn, "contrive" in pertinent part is defined as "[t]o devise; to plan; to plot . . . [t]o fabricate . . . design; invent . . . to scheme . . . ." The Commission also ignores the use of the terms "[t]o use or employ," language that is supportive of the view that Congress did not intend § 10 (b) to embrace negligent conduct.

[21] Webster's International Dictionary, *supra*, defines "manipulate" as "to manage or treat artfully or fraudulently; as to *manipulate* accounts . . . . 4. *Exchanges*. To force (prices) up or down, as by matched orders, wash sales, fictitious reports . . . ; to rig."

Vacate & Remand 6 - 3

79-66 Aaron v. SEC — Conf. 2/27/80

The Chief Justice Affirm. On Reconsideration, Vacate.
The DC found both scienter & neg. But CA 2 didn't decide case on the scienter finding - it went way beyond what ~~[illegible]~~ was necessary.
An injunction is a severe penalty.
Here facts indicate "scienter" and ~~or~~ "reckless disregard".
CJ prefers an affirmance, accepting DC's finding of scienter.
Tinkler op. ranges too widely

Mr. Justice Brennan Affirm

(No discussion)

Mr. Justice Stewart Vacate for Reconsideration
CA 2 did nothing with scienter. It didn't reach that issue. It held only that 10b & 17a 2 only require negligence. This is only Q before us.
~~[illegible]~~ Hochfelder, can be read in two ways: (1) in private causes of action ~~[illegible]~~ scienter must be proved or (2) rule is diff. as to injunctions. Concludes that scienter is required under 10(b) but not under 17 a(2) & (3). Injunctions are fatal to Broker/Dealer

[Left margin:] ~~Cont~~ 10b requires a "knowing violation" but 17 a requires only ~~[illegible]~~ an omission or misstatement of fact.

[Right margin:] We should say SEC should be cautious about issuing an injunction

Mr. Justice White Vacate & Remand to determine in light of our opn.

Agree generally with P.S.

17a(2)+3 doesn't require scienter.

But 10(b) is different & violation

but be knowing under Hochfelder.

There are ~~rescission~~ rescission cases enjoining fraud - but not relevant ??

SEC usually warns a broker dealer before & going to Court.

Shouldn't be easy to get an injunction - in too remote. Mere neg. rarely enough.

Mr. Justice Marshall Affirm

No dissent

Mr. Justice Blackmun Affirm

Mr. Justice Powell Vacate - as suggested by PS & BRW

Agree with P.S. & B.R.W.
(I discussed this with P.S.
before Conference)

Mr. Justice Rehnquist Vacate

Agree with BRW, PS & LFP.

Mr. Justice Stevens Vacate & Remand

Could join an opinion like that suggested by C.J. Could Reverse on ground that CA 2 should not have vacated reg. case.

Would not have joined Hochfelder but will accept it: Applies to ~~Rule~~ injunctions as well as damage action.

Agree no scienter is required by 17a.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

March 3, 1980

Re: 79-66 - Aaron v. S.E.C.

Dear Potter:

I find here, as with a half dozen of this week's cases, that there are wide disparities in the basis of a majority even when five or more agree on the result.

In this case you may recall my view that the Court of Appeals decided the issue of scienter when it was not necessary to do so. (a) The District Court found scienter but gratuitously went on to say "negligence of one may suffice . . ."; (b) the Court of Appeals did not disturb the finding and indeed relied on it in part. (See page 21a, App. to Pet. For Cert.)

As I stated at Conference, the Court of Appeals opinion goes beyond the need for a holding that negligence alone is enough. For me, the issue I thought we had is not here. I therefore conclude to take that position, in which I am joined by no one as of now. In these circumstances, I would remand to require the Court of Appeals to reconsider its holding in light of there being no need to pass on the scienter issue on this record.

Bill Brennan would affirm across the board; five votes (without mine) were to vacate and remand but not on the same basis as I think we should do so. In light of this, I would prefer to have you assign and my narrower ground for remanding can be stated in concurrence.

Regards,

Mr. Justice Stewart

Copies to the Conference

To: The Chief Justice
Mr. Justice Brennan
Mr. Justice White
Mr. Justice Marshall
Mr. Justice Blackmun
Mr. Justice Powell
Mr. Justice Rehnquist
Mr. Justice Stevens

From: Mr. Justice Stewart

Circulated: 16 APR 1980

Recirculated: _____

1st DRAFT

SUPREME COURT OF THE UNITED STATES

No. 79-66

Peter E. Aaron, Petitioner, v. Securities and Exchange Commission. | On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[April —, 1980]

MR. JUSTICE STEWART delivered the opinion of the Court.

The issue in this case is whether the Securities and Exchange Commission (Commission) is required to establish scienter as an element of a civil enforcement action to enjoin violations of § 17 (a) of the Securities Act of 1933 (1933 Act), § 10 (b) of the Securities Exchange Act of 1934 (1934 Act), and Commission Rule 10b-5 promulgated under that section of the 1934 Act.

I

When the events giving rise to this enforcement proceeding occurred, the petitioner was a managerial employee at E. L. Aaron & Co. (the firm), a registered broker-dealer with its principal office in New York City. Among other responsibilities at the firm, the petitioner was charged with supervising the sales made by its registered representatives and maintaining the so-called "due diligence" files for those securities in which the firm served as a market maker. One such security was the common stock of Lawn-A-Mat Chemical & Equipment Corp. (Lawn-A-Mat), a company engaged in the business of selling lawn care franchises and supplying its franchisees with products and equipment.

Between November 1974 and September 1975, two registered representatives of the firm, Norman Schreiber and Do

4, 6, 8, 11

See p 16 that deals § 17(a)(3) differently from my tentative view - but persuades me.

P.S.

Mr. Justice -

Uncharacteristically long for PS, but I nice job and consistent with your views at Conference.

David

Received 4/16-17

I agree with David. This leans heavily & properly on Ernst & Ernst.

I'll join. LFP

ald Jacobson, conducted a sales campaign in which they repeatedly made false and misleading statements in an effort to solicit orders for the purchase of Lawn-A-Mat common stock. During the course of this promotion, Schreiber and Jacobson informed prospective investors that Lawn-A-Mat was planning or in the process of manufacturing a new type of small car and tractor, and that the car would be marketed within six weeks. Lawn-A-Mat, however, had no such plans. The two registered representatives also made projections of substantial increases in the price of Lawn-A-Mat common stock and optimistic statements concerning the company's financial condition. These projections and statements were without basis in fact, since Lawn-A-Mat was losing money during the relevant period.

Upon receiving several complaints from prospective investors, an officer of Lawn-A-Mat informed Schreiber and Jacobson that their statements were false and misleading and requested them to cease making such statements. This request went unheeded.

Thereafter, Milton Kean, an attorney representing Lawn-A-Mat, communicated with the petitioner twice by telephone. In these conversations, Kean informed the petitioner that Schreiber and Jacobson were making false and misleading statements and described the substance of what they were saying. The petitioner, in addition to being so informed by Kean, had reason to know that the statements were false, since he knew that the reports in Lawn-A-Mat's due diligence file indicated a deteriorating financial condition and revealed no plans for manufacturing a new car and tractor. Although assuring Kean that the misrepresentations would cease, the petitioner took no affirmative steps to prevent their recurrence. The petitioner's only response to the telephone calls was to inform Jacobson of Kean's complaint and to direct him to communicate with Kean. Otherwise, the petitioner did nothing to prevent the two registered representatives under

his direct supervision from continuing to make false and misleading statements in promoting Lawn-A-Mat common stock.

In February 1976, the Commission filed a complaint in the District Court for the Southern District of New York against the petitioner and seven other defendants in connection with the offer and sale of Lawn-A-Mat common stock. In seeking preliminary and final injunctive relief pursuant to § 20 (b) of the 1933 Act and § 21 (d) of the 1934 Act, the Commission alleged that the petitioner had violated and aided and abetted violations of three provisions—§ 17 (a) of the 1933 Act, § 10 (b) of the 1934 Act, and Commission Rule 10b–5 promulgated under that section of the 1934 Act.[1] The gravamen of the charges against the petitioner was that he knew or had reason to know that the employees under his supervision were engaged in fraudulent practices, but failed to take adequate steps to prevent those practices from continuing. Before commencement of the trial, all the defendants except the petitioner consented to the entry of permanent injunctions against them.

Following a bench trial, the District Court found that the petitioner had violated and aided and abetted violations of § 17 (a), § 10 (b), and Rule 10b–5 during the Lawn-A-Mat sales campaign and enjoined him from future violations of these provisions.[2] The District Court's finding of past violations was based upon its factual finding that the petitioner had intentionally failed to discharge his supervisory responsibility to stop Schreiber and Jacobson from making state-

[1] The Commission also charged the petitioner and three other defendants with violations of the registration provisions of §§ 5 (a), (c) of the 1933 Act, 15 U. S. C. §§ 77e (a), (c) (1976). The District Court found that the petitioner had violated these provisions and enjoined him from future violations. The Court of Appeals affirmed this holding, and the petitioner has not challenged this portion of the Court of Appeal's decision.

[2] The opinion of the District Court is reported in Fed. Sec. L. Rep. (CCH), at ¶ 96,043.

ments to prospective investors that the petitioner knew to be false and misleading. Although noting that negligence alone might suffice to establish a violation of the relevant provisions in a Commission enforcement action, the District Court concluded that the fact that the petitioner "intentionally failed to terminate the false and misleading statements made by Schreiber and Jacobson, knowing them to be fraudulent, is sufficient to establish his scienter under the securities laws." As to the remedy, even though the firm had since gone bankrupt and the petitioner was no longer working for a broker-dealer, the District Court reasoned that injunctive relief was warranted in light of "the nature and extent of the violations . . . , the [petitioner's] failure to recognize the wrongful nature of his conduct and the likelihood of the [petitioner] repeating his violative conduct."

The Court of Appeals for the Second Circuit affirmed the judgment. *SEC* v. *Aaron*, 605 F. 2d 612. Declining to reach the question whether the petitioner's conduct would support a finding of scienter, the Court of Appeals held instead that when the Commission is seeking injunctive relief, "proof of negligence alone will suffice" to establish a violation of § 17 (a), § 10 (b), and Rule 10b–5. *Id.*, at 619. With regard to § 10 (b) and Rule 10b–5, the Court of Appeals noted that this Court's opinion in *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185, which held that an allegation of scienter is necessary to state a private cause of action for damages under § 10 (b) and Rule 10b–5, had expressly reserved the question whether scienter must be alleged in a suit for injunctive relief brought by the Commission. *Id.*, at 194, n. 12. The conclusion of the Court of Appeals that the scienter requirement of *Hochfelder* does not apply to Commission enforcement proceedings was said to find support in the language of § 10 (b), the legislative history of the 1934 Act, the relationship between § 10 (b) and the overall enforcement scheme of the securities laws, and the "compelling distinctions between private actions and govern-

ment injunction actions."[3] For its holding that scienter is not a necessary element in a Commission injunctive action to enforce § 17 (a), the Court of Appeals relied on its earlier decision in *SEC* v. *Coven*, 581 F. 2d 1020. There that court had noted that the language of § 17 (a) contains nothing to suggest a requirement of intent and that, in enacting § 17 (a), Congress had considered a scienter requirement, but instead "opted for liability without willfulness, intent to defraud, or the like." *Id.*, at 1027–1028.[4] Finally, the Court of Appeals affirmed the District Court's holding that, under all the facts and circumstances of this case, the Commission was entitled to injunctive relief. 605 F. 2d, at 623–624.

We granted certiorari to resolve the conflict in the federal courts as to whether the Commission is required to establish scienter—an intent on the part of the defendant to deceive, manipulate, or defraud[5]—as an element of a Commission

[3] The Court of Appeals observed that its previous decisions had required scienter in private damage actions under § 10 (b) even before this Court's decision in the *Hochfelder* case, but also had "uniformly . . . held that the language and history of the section did not require a showing of scienter in an injunction action brought by the Commission." 605 F. 2d, at 620–621. This distinction had been premised on the fact that the two types of suits under § 10 (b) advance different goals: actions for damages are designed to provide compensation to individual investors, whereas suits for injunctive relief serve to provide maximum protection for the investing public. In the present case, the Court of Appeals, relying on its reasoning in previous cases, concluded that "[i]n view of the policy considerations underlying the securities acts, . . . the increased effectiveness of government enforcement actions predicated on a showing of negligence alone outweigh[s] the danger of potential harm to those enjoined from violating the securities laws." *Id.*, at 621.

[4] Neither the District Court nor the Court of Appeals gave any indication of which subsection or subsections of § 17 (a) of the 1933 Act the petitioner had violated.

[5] The term "scienter" is used throughout this opinion, as it was in *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185, at 193, n. 12, to refer to "a mental state embracing intent to deceive, manipulate, or defraud." We have no occasion here to address the question, reserved in *Hochfelder*,

enforcement action to enjoin violations of § 17 (a),[6] § 10 (b), and Rule 10b-5.[7] 444 U. S. 914.

II

The two substantive statutory provisions at issue here are § 17 (a) of the 1933 Act, 15 U. S. C. § 77q (a), and § 10 (b) of the 1934 Act, 15 U. S. C. § 78j (b). Section 17 (a), which applies only to sellers, provides:

> "It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> "(1) to employ any device, scheme, or artifice to defraud, or
>
> "(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Section 10 (b), which applies to both buyers and sellers,

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ibid., whether, under some circumstances, scienter may also include reckless behavior.

[6] Compare, *e. g.*, the present case, and *SEC* v. *Coven*, 581 F. 2d 1020 (CA2 1978) (scienter not required in Commission enforcement action under § 17 (a)(1)–(3)), with *Steadman* v. *SEC*, 603 F. 2d 1126 (CA5 1979) (scienter required in Commission enforcement action under § 17 (a)(1), but not under § 17 (a)(2)–(3)), and with *SEC* v. *Cenco*, 436 F. Supp. 193 (ND Ill. 1977) (scienter required in Commission enforcement action under § 17 (a)(1)–(3)).

[7] Compare, *e. g.*, the present case, and *SEC* v. *World Radio Mission, Inc.*, 544 F. 2d 535 (CA1 1976) (scienter not required in Commission enforcement action under § 10 (b) and Rule 10b-5), with *SEC* v. *Blatt*, 583 U. S. 1325 (CA5 1978) (scienter required in Commission enforcement action under § 10 (b) and Rule 10b-5).

makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Pursuant to its rulemaking power under this section, the Commission promulgated Rule 10b–5, which now provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> "(a) To employ any device, scheme, artifice to defraud,
>
> "(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> "in connection with the sale or purchase of any security." 17 CFR § 240.10b–5 (1979).

The civil enforcement mechanism for these provisions consists of both express and implied remedies. The express remedy is a suit by the Commission for injunctive relief. Section 20 (b) of the 1933 Act, 15 U. S. C. § 77t (b), provides:

> "Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter [*e. g.*, § 17 (a)], or of any rule or regulation prescribed under the authority thereof, it may in its discretion, bring an action in any district court of the United States . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond."

Similarly, § 21 (d) of the 1934 Act, 15 U. S. C. § 78u (d), authorizes the Commission to seek injunctive relief whenever it appears that a person "is engaged in or is about to engage in any acts or practices constituting" a violation of the 1934 Act, [*e. g.*, § 10 (b)], or regulations promulgated thereto, [*e. g.*, Rule 10b–5], and requires a district court "upon a proper showing" to grant injunctive relief.

The other facet of civil enforcement is a private cause of action for money damages. This remedy, unlike the Commission injunctive action, is not expressly authorized by statute, but rather has been judicially implied. See *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U. S., at 196–197. Although this Court has repeatedly assumed the existence of an implied cause of action under § 10 (b) and Rule 10b–5, see *Ernst & Ernst* v. *Hochfelder*, *supra*; *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723, 730; *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 150–154; *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 404 U. S. 6, 13, n. 9, it has not had occasion to address the question whether a private cause of action exists under § 17 (a). See *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, at 733, n. 6.

The issue here is whether the Commission in seeking injunctive relief either under § 20 (b) for violations of § 17 (a), or under § 21 (d) for violations of § 10 (b) or Rule 10b–5, is required to establish scienter. Resolution of that issue could depend upon (1) the substantive provisions of § 17 (a), § 10 (b), and Rule 10b–5, or (2) the statutory provisions authorizing injunctive relief "upon a proper showing," § 20 (b) and § 21 (d). We turn to an examination of each to determine the extent to which they may require proof of scienter.

A

In determining whether scienter is a necessary element of a violation of § 10 (b) and Rule 10b–5, we do not write on a clean slate. Rather, the starting point for our inquiry is *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185, a case in which

the Court concluded that a private cause of action for damages will not lie under § 10 (b) and Rule 10b–5 in the absence of an allegation of scienter. Although the issue presented in the present case was expressly reserved in *Hochfelder*, *id.*, at 193, n. 12, we nonetheless must be guided by the reasoning of that decision.

The conclusion in *Hochfelder* that allegations of simple negligence could not sustain a private cause of action for damages under § 10 (b) and Rule 10b–5 rested on several grounds. The most important was the plain meaning of the language of § 10 (b). It was the view of the Court that the terms "manipulative," "device," and "contrivance"—whether given their commonly accepted meaning or read as terms of art—quite clearly evinced a congressional intent to proscribe only "knowing or intentional misconduct." *Id.*, at 197–199. This meaning, in fact, was thought to be so unambiguous as to suggest that "further inquiry may be unnecessary." *Id.*, at 201.

The Court in *Hochfelder* nonetheless found additional support for its holding in both the legislative history of § 10 (b) and the structure of the civil liability provisions in the 1933 and 1934 Acts. The legislative history, though "bereft of any explicit explanation of Congress' intent," contained "no indication . . . that § 10 (b) was intended to proscribe conduct not involving scienter." *Id.*, 201–202. Rather, as the Court noted, a spokesman for the drafters of the predecessor of § 10 (b) described its function as a "catch-all clause to prevent manipulative devices." *Id.*, at 202. This description, as well as various passages in the Committee Reports concerning the evils to which the 1934 Act was directed, evidenced a purpose to proscribe only knowing or intentional misconduct. Moreover, with regard to the structure of the 1933 and 1934 Acts, the Court observed that in each instance in which Congress had expressly created civil liability, it had specified the standard of liability. To premise civil liability under § 10 (b) on

merely negligent conduct, the Court concluded, would run counter to the fact that wherever Congress intended to accomplish that result, it said so expressly and subjected such actions to significant procedural restraints not applicable to § 10 (b). *Id.*, at 206–211. Finally, since the Commission's rulemaking power was necessarily limited by the ambit of its statutory authority, the Court reasoned that Rule 10b–5 must likewise be restricted to conduct involving scienter.[8]

In our view the rationale of *Hochfelder* ineluctably leads to the conclusion that scienter is an element of a violation of § 10 (b) and Rule 10b–5, regardless of the identity of the plaintiff or the nature of the relief sought. Two of the three factors relied upon in *Hochfelder*—the language of § 10 (b) and its legislative history—are applicable whenever a violation of § 10 (b) or Rule 10b–5 is alleged, whether in a private cause of action for damages or in a Commission injunctive action under § 21 (d).[9] In fact, since *Hochfelder* involved an implied cause of action that was not within the contemplation of the Congress that enacted § 10 (b), *id.*, at 196, it would be quite anomalous in a case like the present one, involving as it does the express remedy Congress created for § 10 (b) violations, not to attach at least as much significance to the fact that the statutory language and its legislative history support a scienter requirement.

Key sentence

The Commission argues that *Hochfelder*, which involved a

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[8] The Court in *Hochfelder* also found support for its conclusion as to the scope of Rule 10b–5 in the fact that the administrative history revealed that "when the Commission adopted the Rule it was intended to apply only to activities that involved scienter." 425 U. S., at 212.

[9] The third factor—the structure of civil liability provisions in the 1933 and 1934 Acts—obviously has no applicability in a case involving injunctive relief. It is evident, however, that the third factor was not determinative in *Hochfelder*. Rather, the Court in *Hochfelder* clearly indicated that the language of the statute, which is applicable here, was sufficient, standing alone, to support the Court's conclusion that scienter is required in a private damage action under § 10 (b). 425 U. S., at 201.

private cause of action for damages, is not a proper guide in construing § 10 (b) in the present context of a Commission enforcement action for injunctive relief. We are urged instead to look to *SEC* v. *Capital Gains Research Bureau*, 375 U. S. 180. That case involved a suit by the Commission for injunctive relief to enforce the prohibition in § 206 (2) of the Investment Advisers Act of 1940, 15 U. S. C. § 80b–6, against any act or practice of an investment adviser that "operates as a fraud or deceit upon any client or prospective client." The injunction sought in *Capital Gains* was to compel disclosure of a practice known as "scalping," whereby an investment adviser purchases shares of a given security for his own account shortly before recommending the security to investors as a long-term investment, and then promptly sells the shares at a profit upon the rise in their market value following the recommendation.

The issue in *Capital Gains* was whether in an action for injunctive relief for violations of § 206 (2) [10] the Commission must prove that the defendant acted with an intent to defraud. The Court held that a showing of intent was not required. This conclusion rested upon the fact that the legislative history revealed that the "Investment Advisers Act of 1940 . . . reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a

[10] The statutory provision authorizing injunctive relief involved in the *Capital Gains* case was § 209 (e) of the Investment Advisors Act, 15 U. S. C. § 80b–9 (e), which provides in relevant part:

"Whenever it shall appear to the Commission that any person has engaged, is engaged, or is about to engage in any act or practice constituting a violation of any provision of this subchapter, or of any rule, regulation, or order hereunder, . . . it may in its discretion bring an action in the proper district court of the United States . . . to enjoin such acts or practices and to enforce compliance with this subchapter or any rule, regulation, or order hereunder. Upon a proper showing that such person has engaged, is engaged, or is about to engage in any such act or practice, . . . , a permanent or temporary injunction or decree or restraining order shall be granted without bond."

congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested." 375 U. S., at 191–192 (footnote omitted). To require proof of intent, the Court reasoned, would run counter to the expressed intent of Congress.

The Court added that its conclusion was "not in derogation of the common law of fraud." *Id.*, at 192. Although recognizing that intent to defraud was a necessary element at common law to recover money damages for fraud in an arm's-length transaction, the Court emphasized that the Commission's action was not a suit for damages, but rather a suit for an injunction in which the relief sought was the "mild prophylactic" of requiring a fiduciary to disclose his transactions in stocks he was recommending to his clients. *Id.*, at 193. The Court observed that it was not necessary in a suit for "equitable or prophylactic relief" to establish intent, for "[f]raud has a broader meaning in equity [than at law] and intention to defraud or to misrepresent is not a necessary element." *Id.*, quoting De Funiak, Handbook of Modern Equity 235 (2d ed. 1956). Moreover, it was not necessary, the Court said, in a suit against a fiduciary such as an investment adviser, to establish all the elements of fraud that would be required in a suit against a party to an arm's-length transaction. Finally, the Court took cognizance of a "growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and that, accordingly, the doctrines must be adapted to the merchandise in issue." *Id.*, at 194. Unwilling to assume that Congress was unaware of these developments at common law, the Court concluded that they "reinforce[d]" its holding that Congress had not sought to require a showing of intent in actions to enjoin violations of § 206 (2). *Id.*, at 195.

The Commission argues that the emphasis in *Capital Gains* upon the distinction between fraud at law and in equity should guide a construction of § 10 (b) in this suit for injunctive relief.[11] We cannot, however, draw such guidance from *Capital Gains* for several reasons. First, wholly apart from its discussion of the judicial treatment of "fraud" at law and in equity, the Court in *Capital Gains* found strong support in the legislative history for its conclusion that the Commission need not demonstrate intent to enjoin practices in violation of § 206 (2). By contrast, as the Court in *Hochfelder* noted, the legislative history of § 10 (b) points towards a scienter requirement. Second, it is quite clear that the language in question in *Capital Gains*, "any . . . practice . . . which *operates* as a fraud or deceit," (emphasis added) focuses not on the intent of the investment adviser, but rather on the effect of a particular practice. Again, by contrast, the Court in *Hochfelder* found that the language of § 10 (b)—particularly the terms "manipulative," "device," and "contrivance."—clearly refers to "knowing or intentional misconduct." Finally, insofar as *Capital Gains* involved a statutory provision regulating the special fiduciary relationship between an investment adviser and his client, the Court there was dealing with

[11] The Commission finds further support for its interpretation of § 10 (b) as not requiring proof of scienter in injunctive proceedings in the fact that Congress was expressly informed of the Commission's interpretation on two occasions when significant amendments to the securities laws were enacted—the Securities Act Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97, and the Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1495—and on each occasion Congress left the administrative interpretation undisturbed. See S. Rep. No. 94-75, 94th Cong., 1st Sess., 76 (1976); H. R. Rep. No. 95-640, 95th Cong., 1st Sess., 10 (1977). But, since the legislative consideration of those statutes was addressed principally to matters other than that at issue here, it is our view that the failure of Congress to overturn the Commission's interpretation falls far short of providing a basis to support a construction of § 10 (b) so clearly at odds with its plain meaning and legislative history. See *SEC* v. *Sloan*, 436 U. S. 103, 119–121.

a situation in which intent to defraud would not have been required even in a common-law action for money damages.[12] Section 10 (b), unlike the provision at issue in *Capital Gains*, applies with equal force to both fiduciary and nonfiduciary transactions in securities. It is our view, in sum, that the controlling precedent here is not *Capital Gains*, but rather *Hochfelder*. Accordingly, we conclude that scienter is a necessary element of a violation of § 10 (b) and Rule 10b–5.

yes

B

In determining whether proof of scienter is a necessary element of a violation of § 17 (a), there is less precedential authority in this Court to guide us. But the controlling principles are well settled. Though cognizant that "Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes,'" *Affiliated Ute Citizens* v. *United States*, *supra*, at 151, quoting, *SEC* v. *Capital Gains Research Bureau*, *supra*, at 195, the Court has also noted that "generalized references to the 'remedial purposes'" of the securities laws "will not justify reading a provision 'more broadly than its language and statutory scheme reasonably permit.'" *Touche Ross & Co.* v. *Redington*, 442 U. S. 560, 578, quoting, *SEC* v. *Sloan*, 436 U. S. 103, 116. Thus, if the language of a provision of the securities laws is sufficiently clear in its context and not at odds with the legislative history, it is unnecessary "to examine the additional considerations of 'policy' . . . that may have

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[12] The Court in *Capital Gains* concluded: "Thus, even if we were to agree with the courts below that Congress had intended, in effect, to codify the common law of fraud in the Investment Advisers Act of 1940, it would be logical to conclude that Congress codified the common law 'remedially' *as the courts had adapted it to the prevention of fraudulent securities transactions by fiduciaries*, not 'technically' as it has traditionally been applied in damage suits between parties to arm's-length transactions involving land and ordinary chattels." 375 U. S., at 195 (emphasis added).

influenced the lawmakers in their formulation of the statute." *Ernst & Ernst* v. *Hochfelder*, *supra*, at 214, n. 33.

The language of § 17 (a) strongly suggests that Congress contemplated a scienter requirement under § 17 (a)(1), but not under § 17 (a)(2) or § 17 (a)(3). The language of § 17 (a)(1), which makes it unlawful "to employ any device, scheme, or artifice to defraud," plainly evinces an intent on the part of Congress to proscribe only knowing or intentional misconduct. Even if it be assumed that the term "defraud" is ambiguous, given its varied meanings at law and in equity, the terms "device," "scheme," and "artifice" all connote knowing or intentional practices.[13] Indeed, the term "device," which also appears in § 10 (b), figured prominently in the Court's conclusion in *Hochfelder* that the plain meaning of § 10 (b) embraces a scienter requirement.[14] *Id.*, at 199.

By contrast, the language of § 17 (a)(2), which prohibits any person from obtaining money or property "by means of any untrue statement of a material fact or any omission to state a material fact," is devoid of any suggestion whatsoever of a scienter requirement. As a well-known commentator has noted, "[t]here is nothing on the face of Clause (2) itself which smacks of *scienter* or intent to defraud." III L. Loss, Securities Regulation 1442 (2d ed. 1961). In fact, this Court in *Hochfelder* pointed out that the similar language of Rule 10b–5 (b) "could be read as proscribing . . . any type of material misstatement or omission . . . that has the effect of

[13] Webster's International Dictionary (2d ed. 1934) defines (1) "device" as "[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme: often, a scheme to deceive; a stratagem; an artifice," (2) "scheme" as "[a] plan or program of something to be done; an enterprise; a project; as, a business *scheme* [, or] [a] crafty, unethical project," and (3) "artifice" as a "[c]rafty device; trickery; also, an artful stratagem or trick; artfulness; ingeniousness."

[14] In addition, the Court in *Hochfelder* noted that the term "to employ," which appears in both § 10 (b) and § 17 (a)(1), is "supportive of the view that Congress did not intend § 10 (b) to embrace negligent conduct." 425 U. S., at 199, n. 20.

defrauding investors, whether the wrongdoing was intentional or not." 425 U. S., at 212.

Finally, the language of § 17 (a)(3), under which it is unlawful for any person "to engage in any transaction, practice, or course of business which *operates* or *would operate* as a fraud or deceit," (emphasis added) quite plainly focuses upon the *effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible. This reading follows directly from *Capital Gains*, which attributed to a similarly worded provision in § 206 (2) of the Investment Advisers Act of 1940 a meaning that does not require a "showing [of] deliberate dishonesty as a condition precedent to protecting investors." 375 U. S., at 200.

It is our view, in sum, that the language of § 17 (a) requires scienter under § 17 (a)(1), but not under § 17 (a)(2) or § 17 (a)(3). Although the parties have urged the Court to adopt a uniform culpability requirement for the three subparagraphs of § 17 (a), the language of the section is simply not amenable to such an interpretation. This is not the first time that this Court has had occasion to emphasize the distinctions among the three subparagraphs of § 17 (a). In *United States* v. *Naftalin*, 441 U. S. 768, 774, the Court noted that each subparagraph of § 17 (a) "proscribes a distinct category of misconduct. Each succeeding prohibition is meant to cover additional kinds of illegalities—not to narrow the reach of the prior sections." (Footnote omitted.) Indeed, since Congress drafted § 17 (a) in such a manner as to compel the conclusion that scienter is required under one subparagraph but not under the other two, it would take a very clear expression in the legislative history of congressional intent to the contrary to justify the conclusion that the statute does not mean what it so plainly seems to say.

We find no such expression of congressional intent in the legislative history. The provisions ultimately enacted as

§ 17 (a) had their genesis in § 13 of identical bills introduced simultaneously in the House and Senate in 1933. H. R. 4314, 73d Cong., 1st Sess. (Mar. 29, 1933); S. 875, 73d Cong., 1st Sess. (Mar. 29, 1933).[15] As originally drafted, § 13 would have made it unlawful for any person

> "willfully to employ any device, scheme, or artifice to defraud or to obtain money or property by means of any false pretense, representation, or promise, or to engage in any transaction, practice, or course of business . . . which operates or would operate as a fraud upon the purchaser."

Hearings on these bills were conducted by both the House Interstate and Foreign Commerce Committee and the Senate Banking and Currency Committee.

The House and Senate Committees reported out different versions of § 13. The Senate Committee expanded its ambit by including protection against the intentionally fraudulent practices of a "dummy," a person holding legal or nominal title but under a moral or legal obligation to act for someone else. As amended by the Senate Committee, § 13 made it unlawful for any person

> "willfully to employ any device, scheme, or artifice or to employ any 'dummy,' or to act as any such 'dummy,' with the intent to defraud or to obtain money or property by means of any false pretense, representation, or promise, or to engage in any transaction, practice, or course of business . . . which operates or would operate as a fraud upon the purchaser. . . ."

See S. 875, 73d Cong., 1st Sess. (Apr. 27, 1933); S. Rep. No. 47, 73d Cong., 1st Sess., 4–5 (1933). The House Committee retained the original version of § 13, except that the word "willfully" was deleted from the beginning of the provi-

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[15] During the House hearings, H. R. 5480 was substituted for H. R. 4314. See H. R. 5480, 73d Cong., 1st Sess. (May 4, 1933).

sion."[16] See H. R. 5480, 73d Cong., 1st Sess., § 16 (a) (May 4, 1933). It also rejected a suggestion that the first clause, "to employ any device, scheme, or artifice," be modified by the phrase, "with intent to defraud." See *ibid.*; Federal Securities Act: Hearings on H. R. 4314 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess., 146 (1933). The House and Senate each adopted the version of the provision as reported out by its Committee. The Conference Committee then adopted the House version with a minor modification not relevant here, see H. R. Conf. No. 152, 73d Cong., 1st Sess., 12, 27 (1933), and it was later enacted into law as § 17 (a) of the 1933 Act.

The Commission argues that the deliberate elimination of the language of intent reveals that Congress considered and rejected a scienter requirement under all three clauses of § 17 (a). This argument, however, rests entirely on inference, for the Conference Report sheds no light on what the Conference Committee meant to do about the question of scienter under § 17 (a).[17] The legislative history thus gives rise to the equally plausible inference that the Conference Committee concluded that (1) in light of the plain meaning of § 17 (a)(1), the language of intent—"willfully" and "with intent to defraud"—was simply redundant, and (2) with regard to

[16] The House Committee also renumbered § 13 as § 16 (a), divided the provision into three subparagraphs, and modified the language of the second subparagraph in a manner not relevant here. See H. R. 5480, 73d Cong., 1st Sess., § 16 (a) (May 4, 1933).

[17] Although explaining that the "dummy" provision in the Senate bill was deleted from § 13 because it was substituted in modified form elsewhere in the statute, H. R. Conf. Rep. No. 152, 73d Cong., 1st Sess., 27 (1933), the Conference Report contained no explanation of why the Conference Committee acquiesced in the decision of the House to delete the word "willfully" from § 13. That the Committee failed to explain why it followed the House bill in this regard is not in itself significant, since the Conference Report, by its own terms, purported to discuss only the "differences between the House bill and the substitute agreed upon by the conferees." *Id.*, at 24. The deletion of the word "willfully" was common to both the House bill and the Conference substitute.

§ 17 (a)(2) and § 17 (a)(3), a "willful[ness]" requirement was not to be included. It seems clear, therefore, that the legislative history, albeit ambiguous, may be read in a manner entirely consistent with the plain meaning of § 17 (a).[18] In the absence of a conflict between reasonably plain meaning and legislative history, the words of the statute must prevail.[19]

C

There remains to be determined whether the provisions authorizing injunctive relief, § 20 (b) of the 1933 Act and § 21 (d) of the 1934 Act, modify the substantive provisions at issue in this case so far as scienter is concerned.

The language and legislative history of § 20 (b) and § 21 (d) both indicate that Congress intended neither to add to nor detract from the requisite showing of scienter under the substantive provisions at issue. Sections 20 (b) and 21 (d) provide that the Commission may seek injunctive relief whenever it appears that a person "is engaged in or [is] about to engage in any acts or practices" constituting a violation of the 1933 or 1934 Acts or regulations promulgated thereunder and that, "upon a proper showing," a district court shall grant the injunction. The elements of "a proper showing" thus include,

[18] The Commission, in further support of its view that scienter is not required under any of the subparagraphs of § 17 (a), points out that § 17 (a) was patterned upon New York's Martin Act, N. Y. Gen. Bus. Law §§ 352–353 (1921), and that the New York Court of Appeals had construed the Martin Act as not requiring a showing of scienter as a predicate for injunctive relief by the New York Attorney General. *People* v. *Federated Radio Corp.*, 244 N. Y. 33, 154 N. E. 655 (1926). But, in the absence of any indication that Congress was even aware of the *Federated Radio* decision, much less that it approved of that decision, it cannot fairly be inferred that Congress intended not only to adopt the language of the Martin Act, but also a state judicial interpretation of that statute at odds with the plain meaning of the language Congress enacted as § 17 (a)(1).

[19] Since the language and legislative history of § 17(a) are dispositive, we have no occasion to address the "policy" arguments advanced by the parties. See *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185, 214, n. 33.

at a minimum, proof that a person is engaged in or is about to engage in a substantive violation of either one of the Acts or of the regulations promulgated thereunder. Accordingly, when scienter is an element of the substantive violation sought to be enjoined, it must be proven before an injunction may issue. But with respect to those provisions such as § 17 (a) (2) and § 17 (a)(3), which may be violated even in the absence of scienter, nothing on the face of § 20 (b) or § 21 (d) purports to impose an independent requirement of scienter. And there is nothing in the legislative history of either provision to suggest a contrary legislative intent.

This is not to say, however, that scienter has no bearing at all on whether a district court should enjoin a person violating or about to violate § 17 (a)(2) or § 17 (a)(3). In cases where the Commission is seeking to enjoin a person "*about* to engage in acts or practices which . . . *will* constitute" a violation of those provisions, the Commission must establish a sufficient evidentiary predicate to show that such future violation may occur. See *SEC* v. *Commonwealth Chemical Co.*, 574 F. 2d 90, 98–100 (CA2 1978) (Friendly, J.); III L. Loss, *supra*, at 1976. An important factor in this regard is the degree of intentional wrongdoing evident in a defendant's past conduct. See *SEC* v. *Wills*, 472 F. Supp. 1250, 1273–1275 (DC 1978). Moreover, as the Commission recognizes, a district court may consider scienter or lack of it as one of the aggravating or mitigating factors to be taken into account in exercising its equitable discretion in deciding whether or not to grant injunctive relief. And the proper exercise of equitable discretion is necessary to ensure a "nice adjustment and reconciliation between the public interest and private needs." *Hecht Co.* v. *Bowles*, 321 U. S. 321, 329.

III

For the reasons stated in this opinion, we hold that the Commission is required to establish scienter as an element of a civil enforcement action to enjoin violations of § 17 (a)(1)

of the 1933 Act, § 10 (b) of the 1934 Act, and Rule 10b–5 promulgated under that section of the 1934 Act. We further hold that the Commission need not establish scienter as an element of an action to enjoin violations of § 17 (a)(2) and § 17 (a)(3) of the 1933 Act. The Court of Appeals affirmed the issuance of the injunction in this case in the misapprehension that it was not necessary to find scienter in order to support an injunction under any of the provisions in question. Accordingly, the judgment of the Court of Appeals is vacated, and the case is remanded to the court for further proceedings consistent with this opinion.

It is so ordered.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

April 16, 1980

Re: No. 79-66 - Aaron v. S.E.C.

Dear Potter:

In due course, I shall try my hand at a dissent in this case.

Sincerely,

Harry

Mr. Justice Stewart

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

April 17, 1980

Re: No. 79-66 - Aaron v. SEC

Dear Potter:

Please join me.

Sincerely,

Mr. Justice Stewart

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

April 17, 1980

Re: No. 79-66 - Peter E. Aaron v. SEC

Dear Potter,

Please join me.

Sincerely yours,

Byron

Mr. Justice Stewart

Copies to the Conference

cmc

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

April 17, 1980

RE: No. 79-66 Aaron v. Securities & Exchange Comm.

Dear Potter:

I will await the dissent in the above.

Sincerely,

Bill

Mr. Justice Stewart

cc: The Conference

April 17, 1980

79-66 Aaron v. SEC

Dear Potter:

Please join me.

Sincerely,

Mr. Justice Stewart

lfp/ss

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

April 29, 1980

Re: 79-66 - Aaron v. SEC

Dear Potter:

Please join me.

Respectfully,

John

Mr. Justice Stewart

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

May 20, 1980

RE: No. 79-66 Aaron v. Securities & Exchange Commission

Dear Harry:

Please join me.

Sincerely,

Bill

Mr. Justice Blackmun

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

May 21, 1980

Re: 79-66 - Aaron v. Securities and Exchange Commission

MEMORANDUM TO THE CONFERENCE:

My "solo" position set out in my memo of March 3 remains essentially intact. I will have a short concurrence out within a week expressing my view.

Regards,

WEB

THE C. J.	W. J. B.	P. S.	B. R. W.	T. M.	H. A B.	L. F. P.	W. H. R.	J. P. S.
		3/3/80						
will write concurring opinion 5/21/80	await dissent 4/17/80	1st draft 4/16/80	join PS 4/17/80	await dissent 4/16/80	will dissent 4/16/80 1st draft	Join PS 4/17/80	Join PS 4/17/80	Join PS 4/29/80
Typed draft 5/28/80 1st draft 5/30/80	Join HAB 5/20/80	2nd draft 5/29/80		Join HAB 5/20/80	con in part + dissenting in part 5/15/80			
				79-66 Aaron v. SEC				