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Securities Regulation - Fraud - Scienter Must Be Established for the SEC to Obtain Injunctive Relief for Violations of Section 17(a) of the Securities Act of 1933, and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934.

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CASENOTES

SECURITIES REGULATION—Fraud—Scienter Must Be Established for the SEC to Obtain Injunctive Relief for Violations of Section 17(a) of the Securities Act of 1933, and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934.

Aaron v. SEC,
___ U.S. ___, 100 S. Ct. 1945, 64 L. Ed. 2d 611 (1980).

Petitioner Aaron, a managerial employee of a registered broker dealer,[1] was responsible for supervising the sales campaigns of the firm's registered representatives. During a campaign for sales of Lawn-A-Mat common stock, two of the broker's representatives knowingly made misrepresentations concerning the financial condition of Lawn-A-Mat in order to promote sales. Although Aaron was made aware of these alleged security violations, he did not take proper actions to terminate this practice. Pursuant to section 20(b) of the Securities Act of 1933 (1933 Act)[2] and section 21(d) of the Securities and Exchange Act of 1934 (1934 Act)[3], the Securities and Exchange Commission (SEC) filed a complaint against petitioner for violations of section 17(a) of the 1933 Act, section 10(b) of the 1934 Act, and SEC Rule 10b-5. The district court found petitioner had violated these sections and enjoined further violations.[4] While the Court

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1. Broker is defined as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." 15 U.S.C. § 78c(a)(4) (1976). A dealer is any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." *Id.* § 78c(a)(5).

2. *Id.* §§ 77a-77aa.

3. *Id.* §§ 78aa to 78hh-1.

4. *See* Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1949, 64 L. Ed. 2d 611, 618 (1980). The district court concluded that petitioner's deliberate disregard of his responsibility constituted scienter. The district court also noted that negligence might be sufficient to create a violation of the pertinent provisions. The court further reasoned that injunctive relief was necessary considering the nature of the infractions, the likelihood that petitioner would repeat his conduct, in addition to the failure of the petitioner to understand his improper conduct. *Id.* at ___, 100 S. Ct. at 1949, 64 L. Ed. 2d at 619.

of Appeals for the Second Circuit affirmed the judgment of the district court, it did not adopt its reasoning.[5] The Supreme Court granted certiorari to resolve the question whether the SEC is compelled to establish scienter in order to enjoin violations of sections 17(a), 10(b), and rule 10b-5[6] due to the conflicting views in this area.[7] Held-*Vacated and remanded.* The SEC is required to establish scienter in civil enforcement actions to enjoin violations of section 17(a)(1) of the 1933 Act, section 10(b) of the 1934 Act, and rule 10b-5 promulgated under the Securities Exchange Act of 1934.[8]

The Securities Act of 1933[9] was the first comprehensive federal regulatory scheme for the distribution of securities.[10] This legislation was en-

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5. *See id.* at ___, 100 S. Ct. at 1949, 64 L. Ed. 2d at 619. The court of appeals declined to decide whether petitioner's conduct would necessitate a finding of scienter, holding instead that proof of negligence alone is sufficient when the SEC is seeking injunctive relief for an alleged violation of sections 17(a), 10(b), and rule 10b-5. The court of appeals also emphasized the "compelling distinctions between private actions and government injunctive actions," noting the Supreme Court expressly reserved the question whether scienter must be alleged to obtain injunctive relief, but held that scienter must be proven to state a private cause of action for money damages in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1975). Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1950 n.3, 64 L. Ed. 2d 611, 619 n.3 (1980). The court of appeals in holding scienter need not be proven in SEC injunctive action for violations of section 17(a), therefore, relied on its earlier decision in *SEC v. Coven*, 581 F.2d 1020, 1028 (2d Cir. 1978). *See* Aaron v. SEC, ____ U.S. ____, ____, 100 S. Ct. 1945, 1950, 64 L. Ed. 2d 611, 619-20 (1980).

6. ____ U.S. ____, ____, 100 S. Ct. 1945, 1950, 64 L. Ed. 2d 611, 619-20 (1980).

7. *Compare* White v. Abrams, 495 F.2d 724, 730 (9th Cir. 1974) (flexible duty standard) *and* Myzel v. Fields, 386 F.2d 718, 735 (8th Cir. 1967) (knowledge of the falseness of the impression produced by the statements is not required) *and* Kohler v. Kohler Co., 319 F.2d 634, 637 (7th Cir. 1963) (statute meant to cover more than deliberately and dishonestly misrepresenting or omitting material facts) *with* Clegg v. Conk, 507 F.2d 1351, 1361-62 (10th Cir. 1974) (conscious fault or scienter necessary) *and* Lanza v. Drexel & Co., 479 F.2d 1277, 1306 (2d Cir. 1973) (willful or reckless disregard for the truth).

8. Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1955-56, 64 L. Ed 2d 611, 625-26 (1980). The Court further noted the Commission need not establish scienter as an element of an action to enjoin violations of sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933. *Id.* at ____, 100 S. Ct. at 1956, 64 L. Ed. 2d at 626.

9. 15 U.S.C. §§ 77a-77aa (1976).

10. *See* United States v. Naftalin, ____ U.S. ____, ___, 99 S. Ct. 2077, 2082, 60 L. Ed. 2d 624, 630 (1979); Demoe v. Dean Witter & Co., 476 F. Supp. 275, 279 (D. Alaska 1979); Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 643 (1978). There are three state law remedies for securities fraud in Texas: (1) the common law fraud action, *see* Huff, *Texas Business and Commerce Code Section 27.01: An Alternative to Federal Securities Fraud Remedies*, 33 SW. L.J. 703, 703 (1979); (2) Section 33 of the Texas Securities Act, *see* TEX. REV. CIV. STAT. ANN. art. 581-33(A)(2) (Vernon Supp. 1980-1981); and (3) Section 27.01 of the Texas Business and Commerce Code, *see* TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968). Section 27.01 was enacted in 1919 and designed to codify in some respects the common law action of fraud. Scienter is omitted from the requirements for an action of misrep-

acted to furnish investors with complete disclosure of pertinent information dealing with public offerings of securities, to protect against fraud,[11] and to encourage fairness and honesty[12] by imposing specific liabilities

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resentation which is indicative of legislative intent. *See* White v. Bond, 355 S.W.2d 225, 229 (Tex. Civ. App.—Amarillo), *rev'd on other grounds*, 362 S.W.2d 295 (Tex. 1962); Keeton, *Rights of Disappointed Purchasers*, 32 TEXAS L. REV. 1, 13 n.39 (1953). Section 27.01 provides:

> (a) Fraud in a transaction involving real estate or stock in a corporation or joint stock company consists of a
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> (1) false representation of a past or existing material fact, when the false representation is
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> (A) made to a person for the purpose of inducing that person to enter into a contract; and
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> (B) relied on by that person in entering into that contract; or
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> (2) false promise to do an act, when the false promise is
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> (A) material;
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> (B) made with the intention of not fulfilling it;
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> (C) made to a person for the purpose of inducing that person to enter into a contract; and
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> (D) relied on by that person in entering into that contract.
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> (b) A person who makes a false representation or a false promise, and a person who benefits from that false representation or false promise, commit the fraud described in Subsection (a) of this section and are jointly and severally liable to the person defrauded for actual damages. The measure of actual damages is the difference between the value of the real estate or stock as represented or promised, and its actual value in the condition in which it is delivered at the time of the contract.
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> (c) A person who willfully makes a false representation or false promise, and a person who knowingly benefits from a false representation or false promise, commit the fraud described in Subsection (a) of this section and are liable to the person defrauded for exemplary damages not to exceed twice the amount of the actual damages.

TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968).

11. *See, e.g.*, United States v. Naftalin, ___ U.S. ___, ___, 99 S. Ct. 2077, 2082, 60 L. Ed. 2d 624, 630 (1979); Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191 (1963); Securities Act of 1933, H.R. 5480, 73d Cong., 1st Sess. § 2 (1933) (Rayburn Bill). Congress also contemplated that securities market regulation might help assist the economy in recovering after the market crash of 1929. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 (1975); HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, SECURITIES ACT OF 1933, H.R. REP. No. 85, 73d Cong., 1st Sess. 2 (1933); Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 643 (1978).

12. A key part of the program was the effort to "achieve a high standard of business ethics . . . in every facet of the securities industry." United States v. Naftalin, ___ U.S. ___, ___, 99 S. Ct. 2077, 2082, 60 L. Ed. 2d 624, 631 (1979); *see, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 727-28 (1975); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-87 (1963); Heizer Corp. v. Ross, 601 F.2d 330, 333 (7th Cir. 1979).

> The purpose of this bill is to protect the investing public and honest business. . . .

upon the offerors.[13] Although the Securities Act of 1933 deals primarily with the regulation of new offerings,[14] the anti-fraud provisions of section 17(a) are an important exception to this limitation.[15] Section 17(a)[16] was enacted to cover any fraudulent schemes in the sale of securities.[17]

Since the legislative history of section 17(a) gives no clear indication regarding the applicable standard of proof,[18] congressional intent must be ascertained from the language of the provision.[19] In the past courts have emphasized a distinction between the three separate actions prohibited

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> The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise; to seek capital by honest presentation against the competition offered to the public through crooked promotion; to restore the confidence of the prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power.

See SEN. COMM. ON INTERSTATE AND FOREIGN COMMERCE, SECURITIES ACT OF 1933, S. REP. No. 47, 73d Cong., 1st Sess. 1 (1933).

13. *See* 15 U.S.C. §§ 77h, 77s, 77t (1976) (injunctions and prosecution of offenses).

14. *See* United States v. Naftalin, ___ U.S. ___, ___, 99 S. Ct. 2077, 2084, 60 L. Ed. 2d 624, 632 (1979); Demoe v. Dean Witter & Co., 476 F. Supp. 275, 279 (D. Alaska 1979); 15 U.S.C. § 77q(a) (1976).

15. *See* United States v. Naftalin, ___ U.S. ___, ___, 99 S. Ct. 2077, 2084, 60 L. Ed. 2d 624, 632 (1979); Demoe v. Dean Witter & Co., 476 F. Supp. 275, 279 (D. Alaska 1979); 15 U.S.C. § 77q(a) (1976).

16. 15 U.S.C. § 77q(a) (1976). Section 17(a) of the 1933 Act which applies only to sellers, provides that:

> 1) to employ any device, scheme, or artifice to defraud, or
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> 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
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> 3) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Id.

17. *See* United States v. Naftalin, ___ U.S. ___, ___, 99 S. Ct. 2077, 2084, 60 L. Ed. 2d 624, 632 (1979); Adato v. Kagan, 599 F.2d 1111, 1115-16 (2d Cir. 1979); Demoe v. Dean Witter & Co., 476 F. Supp. 275, 279 (D. Alaska 1979); Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 182 (1933).

18. *See* H.R. 4314, 73d Cong., 1st Sess., 77 CONG. REC. 1006 (1933). The provision which was enacted as section 17(a) began as section 13 of like bills introduced in the Senate and the House contemporaneously. The House version, which ultimately was adopted, contained no requirement of willfullness or "intent to defraud." *See* Steadman v. SEC, 603 F.2d 1126, 1133 (5th Cir. 1979); SEC v. Coven, 581 F.2d 1020, 1027 (2d Cir. 1978).

19. *See* United States v. Naftalin, ___ U.S. ___, ___, 99 S. Ct. 2077, 2084, 60 L. Ed. 2d 624, 633 (1979); Demoe v. Dean Witter & Co., 476 F. Supp. 275, 279 (D. Alaska 1979); HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, SECURITIES ACT OF 1933, H.R. REP. No. 85, 73d Cong., 1st Sess. 6 (1933).

under section 17(a), even though a uniform requirement for culpability has been urged.[20] In determining precisely what action is prohibited under subsection 17(a)(1) the statutory language must be examined. Subsection 17(a)(1) contains the word "device"[21] which has been found to be suggestive of intentional conduct.[22] The words "to defraud" modify "device," "scheme," and "artifice,"[23] implying intentional conduct is required.[24] Courts have held a reading of these terms in conjunction with the word "employ" further supports the conclusion that Congress would not have adopted such language to extend liability simply to negligent actions.[25]

The Securities Exchange Act of 1934[26] was designed primarily for the protection of investors in security trading.[27] Another purpose of the Act was to restore public confidence in the marketplace by implementing stricter fraud provisions than the preceding 1933 Act.[28] Although both the

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20. *See* United States v. Naftalin, ___ U.S. ___, ___, 99 S. Ct. 2077, 2082, 60 L. Ed. 2d 624, 630 (1979); Steadman v. SEC, 603 F.2d 1128, 1132 (5th Cir. 1979); Demoe v. Dean Witter & Co., 476 F. Supp. 275, 279 (D. Alaska 1979). The Court in *Naftalin* stressed that the use of an infinitive to introduce each of the three subsections coupled with the use of the conjunction "or" at the end of the first two provisions prohibits a distinct category of misconduct. Each subsection is meant to cover additional types of illegalities, not to restrict the scope of the prior provisions. *See* United States v. Naftalin, ___ U.S. ___, ___, 99 S. Ct. 2077, 2082, 60 L. Ed. 2d 624, 630 (1979).

21. *See* 15 U.S.C. § 77q(a)(1) (1976).

22. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976). The *Hochfelder* Court construed the term "device" to indicate intentional conduct when read together with "manipulative" and "deceptive." *Id.* at 197.

23. Steadman v. SEC, 603 F.2d 1126, 1133 (5th Cir. 1979). The phrases which result are "device to defraud," "scheme to defraud," or "artifice to defraud." *Id.* at 1133.

24. *Id.* at 1133.

25. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 n.20 (1976); Steadman v. SEC, 603 F.2d 1125, 1133 (5th Cir. 1979).

26. 15 U.S.C. §§ 78a-78kk (1976).

27. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976); Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970); Securities and Exchange Act of 1934, H.R. 9323, 73d Cong., 2d Sess. (1934) (Fletcher-Rayburn Bill); Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 645 (1978); 10 SETON HALL L. REV. 720, 724 (1980).

28. *See* James v. Gerber Prod. Co., 483 F.2d 944, 946 (6th Cir. 1973); Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970); Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 645 (1978); 10 SETON HALL. L. REV. 720, 724 (1980). Section 17(a) of the 1933 Act had no express provisions for a private cause of action. The 1934 Act had three distinct provisions for private causes of action. Section 9(e) of the 1934 Act provides for a private action against one who willfully has engaged in market manipulation. *See* 15 U.S.C. § 78i(e) (1976). Section 18(a) provides for a private right of action for an investor who has been defrauded by relying on documents filed with SEC. *See id.* § 78u(e). Section 16(b) provides for disgorgement of all insiders for short-swing profits. *See id.* § 78p(b). Despite these express liability provi-

1933 Act[29] and the 1934 Act[30] contained specific civil and criminal remedies, Congress realized a statutory program would not accomplish the desired effective control of securities.[31] As part of the 1934 Act, therefore, Congress created the Securities and Exchange Commission.[32] The commission was established as a national agency with a wide range of flexible powers including rule making and registration authority.[33]

Section 10(b) of the 1934 Act[34] evolved from three separate bills.[35] The legislative history of the 1934 Act is not explicit as to the intended scope of section 10(b)[36] nor is there any provision in this section expressly addressing the types of conduct prohibited.[37] The SEC promulgated rule

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sions fraud liability is grounded on the implied causes of action under section 10(b) and rule 10(b)-5. *See* Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 645 (1978).

29. *See, e.g.*, 15 U.S.C. §§ 77a-77aa (1976). The following are examples of civil remedies in the 1933 Act: *id.* § 77k (false registration statement); *id.* § 77e (prospectuses and communication); *id.* § 77t (injunction and presentation of offenses).

30. *See, e.g., id.* §§ 78a-78kk. The following are examples of civil remedies in the 1934 Act: *id.* § 78r (misleading statements); *id.* § 78t(c) (hindering the making or filing of any document).

31. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976).

32. *See* 15 U.S.C. § 78d-1 (1976).

33. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976); 15 U.S.C. § 78d-1 (1976); 1 L. LOSS, SECURITIES REGULATION 129, 131 (1961). Four purposes of the Securities and Exchange Commission are: (1) to prevent fraud and afford remedies for fraud, (2) to afford a measure of disclosure to people who buy and sell securities, (3) to regulate securities market, and (4) to control the amount of the Nation's credit which goes into the markets. *See id.* at 131.

34. 15 U.S.C. § 78j(b) (1976). Section 10(b) of the 1934 Act provides in pertinent part: "It shall be 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." *Id.*

35. *See* H.R. 7852, 73d Cong., 1st Sess., 78 CONG. REC. 2378 (1934). Senator Fletcher and Representative Rayburn introduced identical bills which prohibited the use of any device or contrivance in a way or manner which the Commission may by its rules and regulations find detrimental to the public interest or the proper protection of investors. *Id.; see* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976). A third bill introduced gave the Commission power to promulgate rules dealing with manipulative or deceptive devices in general. *See* Securities and Exchange Act of 1934, H.R. 9323, 73d Cong., 2 Sess. § 9 (1934) (Fletcher-Rayburn Bill). An amended version of this bill constitutes the current language of section 10(b). *See* HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, SECURITIES ACT OF 1934, H.R. CONF. REP. No. 1838, 73d Cong., 2d Sess. 32-33 (1934).

36. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 202 (1976). The *Hochfelder* Court noted there was no indication that section 10(b) was enacted to proscribe conduct besides that involving scienter. The Court, in reading this conclusion, relied on a comment by the spokesman for the Act's drafters that section 10(b) was a "catch-all clause to prevent manipulative devices." *Id.* at 202-03.

37. *See* 15 U.S.C. § 78 (1976).

10b-5[38] eight years later in an effort to clarify the types of conduct sections 10(b) and 17(a) made unlawful.[39] Courts have found the language of rule 10b-5 could possibly encompass negligent behavior;[40] however, the administrative history narrows the scope of the rule as applying only to intentional behavior.[41]

While section 17(a) of the 1933 Act, section 10(b) of the 1934 Act, and rule 10b-5 set out the provisions constituting violations, section 20(b) of the 1933 Act and section 21(d) of the 1934 Act provide for remedial relief from these violations.[42] These civil enforcement provisions expressly provide that the Commission has the power to seek injunctive relief when it appears a person is violating or is about to violate a provision of the ap-

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38. 17 C.F.R. § 240, rule 10b-5 (1980). Rule 10b-5 provides in pertinent part that:

> [I]t shall be unlawful for any person to . . . (a) employ any device, scheme, artifice to defraud; (b) to make false statements of material fact or to omit to state such statement; (c) to engage in any act which operates or would operate as fraud in connection with sale or puchase of any security.

See id. This rule was patterned after section 17(a) of the 1933 Act. 15 U.S.C. §§ 77a-77aa (1976); *see* 1 A. BROMBERG, SECURITIES LAW § 2.2 (1970). Rule 10b-5 has been the most widely employed of all federal anti-fraud provisions and has been interpreted to be a rule which equalizes the bargaining positions of parties to securities transactions, promotes disclosure, regulates insider transactions, and encourages fairness and services to promote the disbursement of information to existing and prospective investors. *Id.*

39. *See* SEC RELEASE No. 3230 (May 21, 1942). *See generally* Barnett, *Neither A Tipper Nor A Tippee Be*, 8 HOUS. L. REV. 278, 279 (1970); Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 647 (1978); 10 SETON HALL L. REV. 720, 725 (1980). Rule 10b-5 was promulgated also to close a federal loophole. The federal loophole being closed is that rule 10b-5 prohibits individuals or companies from buying securities if they engage in fraud in their purchase. Previous provisions applied only to sellers. Another primary purpose for the promulgation of rule 10b-5 was to curb the use of inside information by those within the corporate structure. *See* Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951).

40. *See* Steadman v. SEC, 603 F.2d 1126, 1132 (5th Cir. 1979). Rule 10b-5 was patterned after section 17(a) which has been construed to include negligent acts; however, the power granted to an administrative agency is not the power to make the law but to adopt regulations furthering the intent of Congress. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 (1976).

41. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 (1976). The *Hochfelder* Court's analysis of the administrative history of the rule noted it was drafted in hasty response to a situation dealing with intentional conduct. There is no indication in the history that this rule was intended to apply to any conduct except that which included scienter. *Id.* at 213 n.32. Further, indication of this intent to require scienter is evidenced in a release issued by the SEC the day rule 10b-5 was promulgated. *See* SEC RELEASE No. 3230 (May 21, 1942); 77 COLUM. L. REV. 419, 424 (1977).

42. 15 U.S.C. § 77t(b) (1976) (codifies section 20(b) of the 1933 Act and gives the Commission authority to enjoin acts that are shown to be violative of the Act upon a proper showing); *id.* § 78u(d) (codifies section 21(d) of the 1934 Act and gives the Commission the authority to enjoin violations of the 1934 Act or rules promulgated thereunder upon a proper showing).

propriate act or any rule promulgated thereunder.[43] The only legal standard specified in the statutes is a "proper showing" that a person has or is about to engage in violations of one of the acts.[44] Sections 20(b) and 21(d) contain no reference regarding whether scienter or negligence is the proper test for violations of sections 17(a), 10(b), and rule 10b-5.[45] As a result, the requisites for an injunction may be satisfied whether the act is performed willfully, negligently, or innocently.[46]

Prior to 1975 the law was well settled concerning the standard of culpability required for the SEC to obtain injunctive relief for violations of section 10(b) and rule 10b-5.[47] Various courts considering the issue adopted the negligence standard in SEC proceedings regardless of the established culpability requirements in private damage actions.[48] In *Ernst & Ernst v. Hochfelder*[49] the Supreme Court had the opportunity to con-

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43. *See id.* §§ 77t(b), 78u(d) (injunctive relief only express remedy provided for by statute).

44. *See* SEC v. Torr, 87 F.2d 446, 450 (2d Cir. 1937); 15 U.S.C. §§ 77t(b), 78u(d) (1976); Berner & Franklin, *Scienter and Securities and Exchange Commission Rule 10b-5 Injunctive Actions: A Reappraisal in Light of Hochfelder*, 51 N.Y.U. L. REV. 769, 772 (1976); Lowenfels, *Scienter or Negligence Required for SEC Injunctions Under Section 10(b) and Rule 10b-5: A Fascinating Paradox*, 33 BUS. LAW. 789, 802 (1978); Comment, *New Light On An Old Debate, Negligence v. Scienter In An SEC Fraud Injunctive Suit*, 51 ST. JOHN'S L. REV. 759, 762 (1977).

45. *See* 15 U.S.C. §§ 77t(b), 78u(d) (1976).

46. *See* SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1100-01 (2d Cir. 1972) (willful violations); Berner & Franklin, *Scienter and Securities and Exchange Commission Rule 10b-5 Injunctive Actions: A Reappraisal in Light of Hochfelder*, 51 N.Y.U. L. REV. 769, 772 (1976); Lowenfels, *Scienter or Negligence Required for SEC Injunctions Under Section 10(b) and Rule 10b-5: A Fascinating Paradox*, 33 BUS. LAW. 789, 802-03 (1978). In essence sections 20(b) and 21(d) have incorporated the legal standard required by case law under sections 17(a) and 10(b) and rule 10b-5. *See* Berner & Franklin, *Scienter and Securities Exchange Commission Rule 10b-5 Injunctive Actions: A Reappraisal in Light of Hochfelder*, 51 N.Y.U. L. REV. 769, 772 (1976).

47. *See* Lowenfels, *Scienter or Negligence Required for SEC Injunctions Under Section 10(b) and Rule 10b-5: A Fascinating Paradox*, 33 BUS. LAW. 789, 791 (1978). For cases holding that negligence alone is sufficient, see *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 809 (2d Cir. 1975); *SEC v. Dolnick*, 501 F.2d 1279, 1284 (7th Cir. 1974); *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 542 (2d Cir. 1973); *SEC v. Pearson*, 426 F.2d 1339, 1343 (10th Cir. 1970). *See generally* Berner & Franklin, *Scienter and Securities Exchange Commission Rule 10b-5 Injunctive Actions: A Reappraisal in Light of Hochfelder*, 51 N.Y.U. L. REV. 769, 781-92 (1976); Comment, *New Light On An Old Debate: Negligence v. Scienter In An SEC Fraud Injunctive Suit*, 51 ST. JOHN'S L. REV. 759, 763 (1977).

48. *See* SEC v. Spectrum, Ltd., 489 F.2d 535, 541-42 (2d Cir. 1973); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1096 (2d Cir. 1972); SEC v. Geyser Minerals Corp., 452 F.2d 876, 880-81 (10th Cir. 1971); Note, *Scienter and Injunctive Relief Under Rule 10b-5*, 11 GEO. L. REV. 879, 880 (1977).

49. 425 U.S. 185 (1976).

sider the requirement of scienter.[50] Relying on the legislative history and language of section 10(b) and rule 10b-5, the Court held scienter was required for private damage actions brought under these two sections.[51] The Court viewed the plain meaning of the language of section 10(b), which includes such terms as "manipulative," "device," and "contrivance," as evidencing congressional intent to proscribe only "knowing or intentional conduct."[52] The question whether scienter was a necessary element in these SEC injunctive relief proceedings, however, was not addressed.[53] As a result of *Hochfelder*, decisions of the federal appellate courts disagreed on the necessity of proving scienter in SEC injunctive actions.[54] The courts were also in conflict as to the culpability requirement necessary for an injunction under section 17(a) of the 1933 Act.[55]

Several cases have distinguished causes of action for private damages sought by individuals and those for injunctive relief sought by the SEC.[56] In making such a distinction the *Aaron* Court relied on the Supreme Court decision in *SEC v. Capital Gains Research Bureau, Inc.*[57] The Court in *Capital Gains* noted that while at common law intent to defraud was necessary to recover money, the Commission's instant action for injunctive relief was a suit for "equitable or prophylactic relief"[58] not re-

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50. *See id.* at 197-99.

51. *Id.* at 197-99.

52. *Id.* at 197-99 (this was the Court's view whether these forms were given their common meaning or read as terms of art).

53. *See id.* at 193-94 n.12.

54. *Cf.* 15 U.S.C. § 45(b) (1976) (showing of scienter not required in Commission's suit for injunction under Federal Trade Commission Act). *Compare* SEC v. Universal Major Indus. Corp., 546 F.2d 1044, 1047 (2d Cir. 1976) (cause of action predicated on negligence sufficient) *and* SEC v. Geotek, 426 F. Supp. 715, 726 (N.D. Cal. 1976) (negligence standard established) *with* SEC v. World Radio Mission, Inc., 544 F.2d 535, 540-41 (1st Cir. 1976) (scienter is required) *and* SEC v. American Realty Trust, 429 F. Supp. 1148, 1171 (E.D. Va. 1977) (mere negligence will not suffice) *and* SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226, 1240-41 (S.D.N.Y. 1976) (scienter required under *Hochfelder* reasoning).

55. *Compare* Steadman v. SEC, 603 F.2d 1126, 1132-33 (5th Cir. 1979) (scienter required under section 17(a)(1) but not under sections 17(a)(2) or 17(a)(3)) *with* SEC v. Coven, 581 F.2d 1020, 1025 (2d Cir. 1978) (scienter not necessary for section 17(a) violation). The *Steadman* court, while noting that Congress intended different standards of fault under section 17(a), followed the *Hochfelder* reasoning concerning the language of rule 10b-5 which was derived from section 17(a)(1). The court's conclusion was that Congress's language carried the implication of intentional conduct and therefore, scienter was required. *See* Steadman v. SEC, 603 F.2d 1126, 1132 (5th Cir. 1979).

56. *See, e.g.*, Chiarella v. United States, ___ U.S. ___, ___, 100 S. Ct. 1108, 1115, 63 L. Ed. 2d 348, 356 (1980); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193 (1963); Lanza v. Drexel & Co., 479 F.2d 1277, 1299 (2d Cir. 1973).

57. 375 U.S. 180, 193 (1963).

58. *Id.* at 93-94. The Court also stressed that the securities laws should be construed flexibly to carry out their purposes and that if the SEC had to prove deliberate intent,

quiring a specific intent.[59] The distinguishing factor between the actions was that the purpose of private causes of action was to redress past violations of securities law through money damages,[60] while actions for injunctive relief were brought to protect the public from future violations.[61] Additionally, private damage actions brought under sections 10(b) and 17(a) must be judicially implied by the courts,[62] whereas the SEC injunctive actions are expressly provided for in the statute.[63] Courts and commentators have continued to disagree over the effect of an injunction on an individual and the standard of culpability required for the SEC to obtain an injunction.[64]

In *Aaron v. SEC*[65] the Supreme Court was guided by its reasoning in *Ernst & Ernst v. Hochfelder*.[66] Considering the language and legislative history of section 10(b), the Court held the terms "manipulative," "device," and "contrivance" referred to knowing or intentional conduct.[67] De-

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injunctive actions would "nullify the protective purposes of the statute." *Id.* at 200-01; *see, e.g.*, Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); SEC v. Coffey, 493 F.2d 1304, 1310 (6th Cir. 1974); SEC v. Barraco, 438 F.2d 97, 98-99 (10th Cir. 1971).

59. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193 (1963).

60. *See* SEC v. Petrofunds, Inc., 420 F. Supp. 958, 960 (S.D.N.Y. 1976); Comment, *New Light on an Old Debate: Negligence v. Scienter in an SEC Fraud Injunctive Suit*, 51 ST. JOHN'S L. REV. 759, 762 (1977).

61. *See* SEC v. Petrofunds, Inc., 420 F. Supp. 958, 960 (S.D.N.Y. 1976); Comment, *New Light on an Old Debate: Negligence v. Scienter In an SEC Fraud Injunctive Suit*, 51 ST. JOHN'S L. REV. 759, 762 (1977).

62. *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) (reaffirmed implied right of action under rule 10b-5); Osborne v. Mallory, 86 F. Supp. 869, 879 (S.D.N.Y. 1949) (recognizing implied right of action under section 17(a)); Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946) (first to recognize implied right of action under rule 10b-5).

63. *See* 15 U.S.C. §§ 77q(a), 78j(b) (1976).

64. *Compare* SEC v. Management Dynamics, Inc., 515 F.2d 801, 808-09 (2d Cir. 1975) (injunction is remedial rather than retributive) *with* SEC v. Parklane Hosiery Co., 422 F. Supp. 477, 486 & n.6 (S.D.N.Y. 1976) (injunctions have detrimental effect on business and reputation). *See generally* Lowenfels, *Scienter or Negligence Required for SEC Injunction Under section 10(b) and Rule 10b-5: A Fascinating Paradox*, 33 BUS. LAW. 789, 806 (1978). Proponents of a negligence standard urge that a lenient test is necessary to further the objective of the code which is to protect the public not the individuals. Consequently, the defendant's acts, not his state of mind, should be the determining factor. On the other hand, an injunction is a harsh standard for mere negligence as it increases exposure to civil liability and loss of livelihood. *Id.* at 806. *See also* ALI FEDERAL SECURITIES CODE § 1602(a) (Proposed Official Draft 1978) (scienter not required for injunction).

65. ___ U.S. ___, 100 S. Ct. 1945, 64 L. Ed. 2d 611 (1980).

66. 425 U.S. 185, 195 (1976).

67. *See* Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1952, 64 L. Ed. 2d 611, 624 (1980). The language of section 10(b), using such terms as "manipulative," "device," or "employ," and its legislative history imply scienter is an element to be established whenever there is an alleged violation of section 10(b) or rule 10b-5. This is to be the standard of

spite the identity of the plaintiff or the type of relief sought, the Court determined scienter must be established to prove a violation of section 10(b) and rule 10b-5.[68] The *Aaron* Court reasoned that if the element of scienter must be proven to obtain a judicially implied remedy in a private cause of action, it would be inconsistent not to require the same standard of culpability for the SEC to obtain the express remedy provided for by statute.[69] The Supreme Court relied upon the clarity of section 17(a)'s language to arrive at the conclusion that scienter is an element of a violation of section 17(a)(1), but not under sections 17(a)(2) or 17(a)(3).[70] The language of section 17(a)(1), reasoned the Court, includes some of the very words evidencing congressional intent to punish only intentional misconduct.[71] Furthermore, the Court felt the language of section 17(a) necessitated a distinction among the three subparagraphs concerning the required culpable state.[72]

The dissenting opinion, while agreeing in part with the majority,[73] criticized the scienter requirement. The minority reasoned the requirement of scienter will hamper the SEC's effectiveness in policing the market, because sections 17(a)(1), 10(b), and rule 10b-5 are the primary anti-fraud sections.[74] The dissenters argued the majority relied too heavily on the reasoning in *Hochfelder*, which dealt with implied remedies, without considering the differences between express and implied remedies.[75] The minority also disagreed that the language of the statute in question necessi-

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culpability whether action is a private action for damages or injunctive relief sought by the Commission. *See id.* at ____, 100 S. Ct. at 1952, 64 L. Ed. 2d at 624.

68. *See id.* at ____, 100 S. Ct. at 1954-55, 64 L. Ed. 2d at 624-25. Intent must now be established for violations of sections 10(b) and 17(a) and rule 10b-5 when actions are initiated by the SEC or private individuals. *Id.* at ____, 100 S. Ct. at 1954-55, 64 L. Ed. 2d at 624-25.

69. *See id.* at ____, 100 S. Ct. at 1954-55, 64 L. Ed. 2d at 624-25. The identical standard should be required because the same substantive provisions apply and because sections 20(b) and 21(d) leave the standard open by requiring a "proper showing." *See id.* at ____, 100 S. Ct. at 1954-55, 64 L. Ed. 2d at 625.

70. *See id.* at ____, 100 S. Ct. at 1955, 64 L. Ed. 2d at 625.

71. *See id.* at ____, 100 S. Ct. at 1955, 64 L. Ed. 2d at 626.

72. *See id.* at ____, 100 S. Ct. at 1956, 64 L. Ed. 2d at 626.

73. *See id.* at ____, 100 S. Ct. at 1959, 64 L. Ed. 2d at 631 (Blackmun, J., dissenting). The dissenters agree scienter is not a necessary requirement for injunctive relief under sections 17(a)(2) and 17(a)(3). *See id.* at ____, 100 S. Ct. at 1959, 64 L. Ed. 2d at 631 (Blackmun, J., dissenting).

74. *See id.* at ____, 100 S. Ct. at 1959, 64 L. Ed. 2d at 631 (Blackmun, J., dissenting).

75. *See id.* at ____, 100 S. Ct. at 1959, 64 L. Ed. 2d at 631 (Blackmun, J., dissenting). The dissenters advocate distinguishing between the two types of actions because the elements of common law fraud vary with the nature of relief sought. It is not necessary in a suit for equitable relief to prove all elements required in a suit for private damages. *See id.* at ____, 100 S. Ct. at 1962, 64 L. Ed. 2d at 634 (Blackmun, J., dissenting) (proof of scienter not required for equitable relief).

tated the requirement of scienter.[76] The majority opinion, the dissent concluded, drives a wedge between sellers and buyers thereby undermining the harmony of the two statutes.[77]

The Supreme Court's decision requiring the SEC to prove scienter to enjoin violations of the anti-fraud provisions of the Securities Acts has major ramifications. In a complex society there is a need for an assertive and efficient federal agency to protect financial interests.[78] As a result of *Aaron* the effectiveness of the Commission to supervise the market will be severely undermined.[79] Sections 17(a) and 10(b) are the primary anti-fraud provisions of the federal securities laws.[80] These sections, therefore, are the primary means through which the Commission, by exerting its authority to bring actions for injunctive relief, can protect the public against deception.[81] By placing a stiffer burden on the SEC it will be easier for fraud to permeate the marketplace.[82]

Requiring the Commission to prove the defendant's intent to make

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76. *See id.* at ____, 100 S. Ct. at 1965, 64 L. Ed. 2d at 638 (Blackmun, J., dissenting). The word "device" which is common to both statutes has a broader scope than the majority suggests. The dissent contends that the Court should have used case definitions and statutory acts to determine congressional intent instead of relying on dictionary definitions. *See id.* at ____, 100 S. Ct. at 1965, 64 L. Ed. 2d at 638 (Blackmun, J., dissenting).

77. *See id.* at ____, 100 S. Ct. at 1965, 64 L. Ed. 2d at 638 (Blackmun, J., dissenting). Since section 17(a) applies only to sellers and section 10(b) and rule 10b-5 apply both to purchasers and sellers, the two statutes do not operate in harmony. The SEC will still be able to obtain relief for negligent misrepresentations under sections 17(a)(2) and 17(a)(3). *Id.* at ____, 100 S. Ct. at 1965, 64 L. Ed. 2d at 638 (Blackmun, J., dissenting).

78. "As a complex society so diffuses and differentiates the financial interests of the ordinary citizens that he has to trust others and cannot personally watch the managers of all his interest as one horse trader watches another, it becomes a condition of the very stability of that society, that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position." Note, *Scienter and Injunctive Relief Under Rule 10b-5*, 11 GEO L. REV. 879, 901 n.100 (1977).

79. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 216 (1976) (Blackmun, J., dissenting); SEC v. Management Dynamics, Inc., 515 F.2d 801, 808-09 (2d Cir. 1975); Note, *Scienter and Rule 10b-5*, 69 COLUM. L. REV. 1057, 1076 (1969). It is not required of other federal policy agencies to prove scienter in order to obtain an injunction against violations of the provisions; therefore, neither should the SEC be burdened. *Cf.* 15 U.S.C. § 45(b) (1976) (showing of scienter not required in Commission suits for injunction under Federal Trade Commission Act).

80. *See, e.g.*, United States v. Naftalin, ____ U.S. ____, ____, 99 S. Ct. 2077, 2082, 60 L. Ed. 2d 624, 630 (1979) (construing section 17(a) of 1933 Act); Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972) (construing section 10(b) of 1934 Act); James v. Gerber Prod. Co., 483 F.2d 944, 946 (6th Cir. 1973) (construing section 10(b) of 1934 Act).

81. *See* SEC v. Coffey, 493 F.2d 1304, 1310 (6th Cir. 1974); Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970).

82. *See* SEC v. Management Dynamics, Inc., 515 F.2d 801, 808-09 (2d Cir. 1975) (the SEC as "statutory guardian" of public interest will not be able to police the market as effectively if they must prove scienter in order to obtain an injunction).

false and misleading statements will lower public confidence in the stockmarket.[83] Without adequate protection from the SEC the public, in the midst of a depressed state of economy,[84] will be hesitant about investing since their risks have been compounded by the SEC's inability to offer adequate investor protection due to the stiffer burden imposed by *Aaron*. One of the primary purposes of the 1933 and 1934 Acts was to restore public confidence in the market after the 1929 crash.[85] The majority decision represents a departure from the course of that policy.

Over emphasizing the plain meaning of the statutory language,[86] the *Aaron* Court relied too heavily on the reasoning set out in *Hochfelder*.[87] The words "device," "scheme," or "artifice" found in section 17(a)(1) and the terms "manipulative" or "deceptive" device or contrivance found in section 10(b) are, however, all used in the disjunctive.[88] They, therefore, do not evidence intentional conduct.[89] Furthermore, nowhere is the word "willfully" present in the statute.[90] The terms should each be given distinct meanings thereby proscribing a wider range of conduct.[91] The Court appeared to be using dictionary definitions for these terms, mechanically applying the definitions even though the terms have been interpreted to have broader meanings.[92]

In addition, the majority decision[93] ignored the differences between private damage actions and public enforcement actions[94] by reaffirming the

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83. *See* Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1959, 64 L. Ed. 2d 611, 631 (1980) (Blackmun, J., dissenting); James v. Gerber Prod. Co. 483 F.2d 944, 946 (6th Cir. 1973).

84. *See* Bond, *Bargain Days for Bond*, 7 PERSONAL FINANCE 129, 129 (April 1980); 5 SMALL BUS. REP. 28, 28 (July 1980).

85. *See generally* James v. Gerber Prod. Co., 483 F.2d 944, 946 (6th Cir. 1973); Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970); HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, SECURITIES ACT OF 1933, H.R. REP. No. 85, 73d Cong., 1st Sess. 2 (1933); Hazen, *A Look Beyond The Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 645 (1978).

86. *See* Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1959, 64 L. Ed. 2d 611, 631 (1980) (Blackmun, J., dissenting).

87. *Id.* at ___, 100 S. Ct. at 1960, 64 L. Ed. 2d at 632 (Blackmun, J., dissenting).

88. *See* 15 U.S.C. §§ 77q(a), 78j(b) (1976).

89. *See* Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1959, 64 L. Ed. 2d 611, 631 (1980) (Blackmun, J., dissenting).

90. *See* 15 U.S.C. §§ 77q(a), 78j(b) (1976).

91. *See* Santa Fe Indus. Inc. v. Green, 430 U.S. 462, 476 (1977) (defining "manipulative" as a "term of art" referring to various practices); Klamberg v. Roth, 473 F. Supp. 544, 550 (S.D.N.Y. 1979) (distinguishing between "deceive" and "deception").

92. Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1960, 64 L. Ed. 2d 611, 632 (1980) (Blackmun, J., dissenting); *see* Santa Fe Indus. Inc. v. Green, 430 U.S. 462, 476 (1977) (using "manipulation" as a "term of art" instead of strict dictionary definition).

93. SEC v. Aaron, ___ U.S. ___, ___, 100 S. Ct. 1945, 64 L. Ed. 2d 611 (1980).

94. *Id.* at ___, 100 S. Ct. at 1962, 64 L. Ed. 2d at 630 (Blackmun, J., dissenting). An

reasoning set out in *Hochfelder*.[95] By ignoring these differences the *Aaron* Court overlooked the necessity for the SEC to employ a comparatively lenient test of negligence, a test that will not cause unbearable harm, to further the policies of the Securities Laws.[96] The top priority of these Securities Acts is to protect the individual.[97] The determining factor in issuing an injunction, therefore, should be the defendant's acts and the impact those acts have on the investing public, not the state of mind of the defendant.[98]

The decreasing availability of remedies at the federal level,[99] coupled with the now limited efficiency of the SEC to police the market, will increase reliance on state law remedies.[100] Private individuals will have to seek the expensive and time consuming remedy of a private action. In Texas, individuals may resort to section 27.01 of the Texas Business and Commerce Code[101] which provides very effective relief for fraudulent

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injunction is prophylactic rather than punitive, similar to a private damage action. *See, e.g.*, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193 (1963); SEC v. Management Dynamics, Inc., 515 F.2d 801, 808-09 (2d Cir. 1975); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 868 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969).

95. SEC v. Aaron, ___ U.S. ___, ___, 100 S. Ct. 1945, 1959, 64 L. Ed. 2d 611, 626 (1980); *see* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976).

96. Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1959, 64 L. Ed. 2d 611, 626 (1980); *see, e.g.*, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193 (1963) (injunction prophylactic not punitive); SEC v. Management Dynamics, Inc., 515 F.2d 801, 808-09 (2d Cir. 1975) (SEC is "statutory guardian" for public); SEC v. Fifth Ave. Coach Lines, Inc., 435 F.2d 515, 517 (2d Cir. 1970) (different culpable standard for SEC actions than for private suits).

97. *See* SEC v. World Radio Mission, 544 F.2d 535, 541 (1st Cir 1976); SEC v. Coffey, 493 F.2d 1304, 1310 (6th Cir. 1974); Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970); SEC v. Van Horn, 371 F.2d 181, 186 (7th Cir. 1966); SEC v. Culpepper, 270 F.2d 241, 250 (2d Cir. 1959); Lowenfels, *Scienter or Negligence Required for SEC Injunctions Under Section 10(b) and Rule 10b-5: A Fascinating Paradox*, 33 BUS. LAW. 789, 806 (1978); 77 COLUM. L. REV. 419, 440 (1977).

98. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 216 (1976) (Blackmun, J., dissenting); SEC v. World Radio Mission, 544 F.2d 535, 541 (1st Cir. 1976); SEC v. Van Horn, 371 F.2d 181, 186 (7th Cir. 1966); Lowenfels, *Scienter or Negligence Required For Injunctive Relief Under Section 10(b) and Rule 10b-5: A Fascinating Paradox*, 33 BUS. LAW. 789, 806 (1978).

99. *See* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 37-41 (1977); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 480-82 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976); Huff, *Texas Business and Commerce Code Section 27.01: An Alternative to Federal Securities Fraud Remedies*, 33 SW. L.J. 703, 703 (1979).

100. *See* Huff, *Texas Business and Commerce Code Section 27.01: An Alternative to Federal Securities Fraud Remedies*, 33 SW. L.J. 703, 703 (1979). Recent United States Supreme Court decisions have curtailed the protection offered by the federal securities laws. *Id.* at 703.

101. TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968).

stock transactions.[102] The most appealing feature of section 27.01 is the absence of a scienter requirement in fraud actions.[103] Texas, therefore, does not predicate liability for damages on the presence of intent.[104] Although the private plaintiff is afforded a lesser burden under section 27.01,[105] the burden of terminating fraud in stock transactions should rest with the SEC.[106] The SEC was designed to terminate fraud in stock transactions; any lesser burden negates the primary reason for its existence.[107]

The Supreme Court has placed a heavy burden on the SEC because of the Court's hesitancy to expand the SEC's power to encompass negligent actions.[108] The SEC no longer has the flexibility necessary to further the intent of the federal securities laws under which it was created. The confusion concerning the degree of culpability required which followed *Hochfelder* has been alleviated by the decision in *Aaron*; however, in solving the culpability problem the burden of instigating action against unfair securities practices has shifted from the government onto the individual. Because securities deal with interstate commerce it is more reasonable to expect uniform nationwide enforcement instead of a piecemeal state-by-state approach which will be the result of *Aaron*.[109] If the pro-

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102. *See id.*; Huff, *Texas Business and Commerce Code Section 27.01: An Alternative to Federal Securities Fraud Remedies*, 33 SW. L.J. 703, 703 (1979). Section 27.01 offers many advantages to a plaintiff, for example: plaintiff need not prove representations of fact made with scienter; plaintiff may bring action on representation made in form of a promise; damages are measured on a loss-of-bargain formula and treble damages may be awarded when representations are willfully made. TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968).

103. *See* TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968) (scienter need not be proven for representation of fact).

104. *See id.*; Huff, *Texas Business and Commerce Code Section 27.01: An Alternative to Federal Securities Fraud Remedies*, 33 SW. L.J. 703, 726 (1979).

105. *See* Huff, *Texas Business and Commerce Code Section 27.01: An Alternative to Federal Securities Fraud Remedies*, 33 SW. L.J. 703, 726 (1979).

106. *See* 1 L. LOSS, SECURITIES REGULATIONS 129, 130-31 (1961).

107. *Id.* at 130-31 (1961). One of the primary reasons for the creation of the SEC under the Securities Exchange Act of 1934 was to protect investors against fraud. Since this is the very reason for the SEC's existence, the burden of investor protection should rest with the SEC. *See* James v. Gerber Prod. Co., 483 F.2d 944, 946 (6th Cir. 1973); Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970).

108. *See* Aaron v. SEC, ___ U.S. ___, ___, 100 S. Ct. 1945, 1954-55, 64 L. Ed. 2d 611, 625-26 (1980).

109. The American Law Institute has drafted a Securities Code to replace the existing Federal Securities Law. *See generally* ALI FEDERAL SECURITIES CODE (Proposed Official Draft 1978). This proposed code contains a single fraud provision prohibiting both "fraudulent acts" and "misrepresentations." *See id.* § 1602(a). Section 1602(a) provides in pertinent part that it is unlawful for any person to engage in a fraudulent act or make a misrepresentation. *Id.* § 1602(a).