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Securities Law: The Scienter Requirement in an SEC Enforcement Action — Should Equity Control?

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SECURITIES LAW: THE SCIENTER REQUIREMENT IN AN SEC ENFORCEMENT ACTION—SHOULD EQUITY CONTROL?—*SEC v. Aaron,* 605 F.2d 612 (2d Cir.), *cert. granted,* 48 U.S.L.W. 3258 (1979) (No. 79-66).

INTRODUCTION

It has been nearly five decades since the havoc of the Depression caused Congress to enact the Securities Act of 1933 and the Securities Exchange Act of 1934.[1] In this time it has become clear that the federal courts have yet to uniformly settle the question of what constitutes a proper cause of action under the antifraud provisions of these Acts.[2] A related problem is whether the elements in a proper cause of action should differ in an action brought by the Securities and Exchange Commission (SEC) as opposed to one for damages brought by a private party.[3]

The Supreme Court decision in *Ernst & Ernst v. Hochfelder*[4] has added to this general uncertainty. While the *Hochfelder* decision dealt with a private action for damages under the antifraud provisions, the reasoning employed by the Supreme Court may indicate that the scienter standard set forth therein also applies to the SEC.[5] The net

1. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 187 (1963); Comment, *Injunctive Relief in SEC Civil Actions: The Scope of Judicial Discretion,* 10 COLUM. J. OF L. & SOC. PROB. 328, 329-35 (1974) [hereinafter cited as *SEC Civil Actions*].

2. *See* SEC v. Penn. Central Co., 450 F. Supp. 908, 918 (E.D.N.Y. 1978); Note, *Scienter's Scope and Application in Rule 10b-5 Actions: An Analysis in Light of Hochfelder,* 52 NOTRE DAME LAW. 925, 926-27 (1977).

The antifraud provisions referred to are, section 17(a) of the 1933 Securities Act, 15 U.S.C. § 77q(a) (1976), section 10(b) of the 1934 Securities Exchange Act, 15 U.S.C. § 78j(b) (1976), and SEC rule 10b-5, 17 C.F.R. § 240.10b-5 (1979), promulgated under section 10(b). *See* note 20 *infra* for texts of these provisions.

3. Section 10(b) of the 1934 Act and SEC rule 10b-5 suggest only an SEC right of action. *See* note 20 *infra*. The private right of action has been inferred. *See* Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

4. 425 U.S. 185 (1976). In *Hochfelder,* the Supreme Court was confronted with a scheme worked out by Leston Nay, President of the First Securities Co. of Chicago. Between 1942 and 1966, Nay induced respondent Hochfelder and others to invest in high yield accounts. In fact, Nay kept the investment funds and made no record of the dealings. In 1968, Nay committed suicide and exposed the fraud in his suicide note. A suit was brought against the accounting firm of Ernst & Ernst, under a theory of negligent nonfeasance. The cause of action, based on section 10(b) and rule 10b-5, alleged that Ernst & Ernst had aided and abetted Nay's violations by failing to conduct proper audits. The Supreme Court held Ernst & Ernst not liable because the accounting firm had not acted with scienter, or the intent to deceive, manipulate, or defraud.

5. The *Hochfelder* Court explicitly refused to deal with the proper elements of an action brought by the SEC for injunctive relief. *Id.* at 194, n.12.

effect of *Hochfelder*, if applied to the SEC, would be to make it more difficult for the SEC to bring a successful action because of the greater burden of proof associated with the scienter standard.[6] On the other hand, a line of Supreme Court decisions, contemporaneous with *Hochfelder*, may indicate that the nation's highest court is only seeking to limit private access to the securities laws.[7]

In light of *Hochfelder* and surrounding uncertainties, a panel of the Second Circuit decided *SEC v. Aaron*.[8] The *Aaron* court determined that *Hochfelder*, a private action for damages, did not apply when the SEC brought suit for injunctive relief.[9] Therefore, the SEC in

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With respect to private actions, the Supreme Court conducted an extensive statutory analysis of section 10(b) and rule 10b-5. The Court concluded that the language and legislative histories of these provisions compelled the view that scienter was a necessary element in the cause of action. *Id.* at 195-206.

While the *Hochfelder* decision clearly applies to private actions under section 10(b), several authorities believe that the decision should be extended to SEC enforcement actions. *See* SEC v. Blatt, 583 F.2d 1325 (5th Cir. 1978); SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226 (S.D.N.Y. 1976), *aff'd on other grounds*, 565 F.2d 8 (2d Cir. 1977). *See also* Berner & Franklin, *Scienter and Securities and Exchange Commission Rule 10b-5 Injunctive Actions: A Reappraisal In Light of Hochfelder*, 51 N.Y.L. REV. 769 (1976) [hereinafter cited as *Scienter A Reappraisal*].

The SEC in *Hochfelder* argued for a qualified negligence standard in private actions. Under the SEC scheme, negligence would be sufficient for liability if: reliance on the "negligent" act had occurred; money damages were ascertainable; and the losses were forseeable. The SEC also urged the Court to remand the case in order to consider possible reckless acts by Ernst & Ernst. Brief by SEC as *Amicus Curiae* at 8-9, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

6. *Hochfelder* requires the plaintiff to show and prove that the defendant had the intent to deceive. This differs from the negligence standard found in SEC v. Aaron, 605 F.2d 612 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66), which merely requires a showing that defendant acted unreasonably. *See* text accompanying notes 85-86 *infra*.

7. Four decisions particularly act to cut off private access to the securities laws: Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975) (suit brought under the 1934 Securities Exchange Act § 13(d), 15 U.S.C. § 78m(d) (1976), requires a showing by plaintiffs of irreparable harm); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (suit brought under rule 10b-5 for damages requires plaintiffs to be actual purchasers or sellers of securities); Securities Investor Protection Corp. v. Barbour, 421 U.S. 412 (1975) (refusing to imply a right of action for customers of broker-dealers to compel the Securities Investor Protection Corp. to exercise its authority under the Security Investor Protection Act of 1970); Touche Ross & Co. v. Redington, 47 U.S.L.W. 4733 (1979) (refusing to imply a private right of action under § 17(a) of the 1934 Act).

8. 605 F.2d 612 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66). The influence of the Second Circuit in securities regulation should not be understated because that circuit has been a leader among the federal courts in this area of the law. Bucklo, *Scienter and Rule 10b-5*, 67 NW. L. REV. 562, 576 (1972).

9. The *Aaron* court noted that while its SEC decisions varied from *Hochfelder* on the scienter issue, the circuit court's private action decisions were consistent with *Hochfelder*. *See* Lanza v. Drexel, 479 F.2d 1277 (2d Cir. 1973) (en banc); Shemtoab v. Shearson, Hammill & Co., 448 F.2d 442 (2d Cir. 1971).

Aaron was required to show only negligent conduct rather than scienter as set forth in *Hochfelder*.[10] Thus, the elements for a proper cause of action under the same antifraud provisions will differ depending upon the identity of the party bringing suit. This apparent inconsistency must be justified if the securities laws are to be rationally applied.[11]

FACTS

Peter E. Aaron was employed by E.L. Aaron & Co., a broker-dealer registered with the SEC. Although Aaron held no corporate title or office and was not registered with the National Association of Securities Dealers as a principal of Aaron & Co., his duties were varied and of the highest order. Specifically, his duties included supervising Aaron & Co. registered representatives and maintaining the firm's new market files. In these roles Aaron knew about the fraudulent and misleading statements being made by Aaron & Co. representatives regarding the Lawn-A-Mat Chemical and Equipment Corp. (LAM). Although Aaron was notified by counsel for LAM that such statements were being made, and knew that the statements being made were false, he did little to halt the activity.[12] The SEC commenced an action in federal district court seeking preliminary and final injunctive relief against Aaron, pursuant to section 20(b) of the 1933 Act and section 21(d) of the 1934 Act.[13] The SEC alleged in the complaint that

10. 605 F.2d 612, 623 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

11. The *Hochfelder* analysis of § 10(b) becomes especially compelling in regard to SEC enforcement actions when it is considered that only the SEC had the authority to bring suit in 1934. *See* note 3 *supra*. Therefore, the congressional intent found by the *Hochfelder* Court, see note 27 *infra*, must have been directed solely at the SEC. The importance of *Hochfelder* in *Aaron* and all SEC enforcement actions cannot be overstated. Note, *The Scienter Requirement in SEC Injunctive Enforcement of Section 10(b) After Ernst & Ernst v. Hochfelder*, 77 COLUM. L. REV. 419, 425 (1977) [hereinafter cited as *Scienter After Hochfelder*]; Note, *Scienter and Injunctive Relief Under Rule 10b-5*, 11 GA. L. REV. 879, 890 (1977) [hereinafter cited as *Scienter Under Rule 10b-5*].

It should be also noted that the SEC in *Hochfelder* argued that the identity of the party bringing suit should not be relevant in a section 10(b) action. Brief by SEC as *Amicus Curiae* at 16-17, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). After *Hochfelder* was decided, the SEC expected greater emphasis by defense lawyers on the scienter issue when the SEC brought suit for injunctive relief. SEC staff counsel were directed to stress the differing policies and purposes underlying SEC actions and private actions in order to maintain the lower standard of culpability in SEC enforcement actions. SEC, GENERAL COUNSEL'S MEMORANDUM REGARDING ERNST & ERNST V. HOCHFELDER.

12. SEC v. Aaron, FED. SEC. L. REP. (CCH) ¶ 96,043 at 91,683 (S.D.N.Y. 1977), *aff'd*, 605 F.2d 612 (2d Cir. 1979), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

13. The 1933 Securities Act § 20(b), 15 U.S.C. § 77t(b) (1976), provides in relevant part: "Whenever it shall appear to the Commission that any person is engaged or

Aaron had aided and abetted the fraudulent activities of Aaron & Co. employees in violation of section 17(a) of the 1933 Act, section 10(b) of the 1934 Act, and rule 10b-5 promulgated under section 10(b). The district court ruled that negligence alone may suffice as a standard for liability in Commission enforcement proceedings.[14] The court found, however, that Peter Aaron had in fact acted with scienter and that Aaron could be held liable under either a negligence or a scienter theory for violation of the antifraud provisions.[15] Therefore, the district court found that the SEC was entitled to a permanent injunction enjoining Aaron from further violations.[16]

DECISION

At the appellate level, Aaron alleged that the lower court had erred in not requiring scienter as a necessary element of proof in SEC enforcement actions.[17] Aaron further alleged that the evidence before the district court was inadequate to establish scienter.[18] The circuit court held that the scienter requirement enunciated in *Hochfelder* was not applicable to government enforcement actions brought under sections 10(b) and 21(d) of the 1934 Act.[19] However, the *Aaron* court accepted the lower court's finding that Peter Aaron had acted with scienter. The district court's finding that Aaron had aided and abetted violations of sections 17(a), 10(b), and SEC rule 10b-5[20] was, therefore, affirmed by

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about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter . . . [the Commission] may in its discretion . . . in any district court . . . [act] to enjoin such acts or practices . . . ."

The 1934 Securities Exchange Act § 21(d) 15 U.S.C. § 78u(d) (1976), provides in relevant part: "Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter . . . [the Commission] may in its discretion bring an action in the proper district court . . . to enjoin such acts or practices . . . ."

For background to these statutes, see L. LOSS, SECURITIES REGULATIONS 1975-83 (2d ed. 1961); 6 L. LOSS SECURITIES REGULATIONS 4108-23 (2d ed. Supp. 1969); *Scienter After Hochfelder*, *supra* note 11, at 430-34; *SEC Civil Actions*, *supra* note 1, at 338-43.

14. SEC v. Aaron, FED. SEC. L. REP. (CCH) ¶ 96,043 at 91,685 (S.D.N.Y. 1977), *aff'd*, 605 F.2d 612 (2d Cir. 1979), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

15. *Id.*

16. *Id.* at 91,687.

17. Brief for Appellant at 39, SEC v. Aaron, 605 F.2d 612 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66). Aaron argued that *Hochfelder* had held that scienter was a required element, regardless of the plaintiff's identity. Therefore, Aaron urged the circuit court to remand the case in order to reevaluate the scienter issue in SEC enforcement actions.

18. *Id.* at 43.

19. SEC v. Aaron, 605 F.2d 612, 619 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

20. *Id.* at 614.

the circuit court, as was the lower court's grant of a permanent injunction against Aaron pursuant to sections 20(b) and 21(d).[21]

In the opinion, the *Aaron* court concluded that Peter Aaron's lack of corporate title would not insulate him from the securities laws.[22] The court then proceeded to address the issue whether scienter is a requirement in an SEC enforcement action. The court distinguished *Hochfelder*, a private action for damages, and recognized a split of opinion among lower courts in regard to this issue.[23] The *Aaron* court reasoned that the purpose of SEC enforcement actions is to provide maximum protection to the investing public at large, while private damage actions are brought to obtain monetary relief only for individual investors. This reasoning compelled the *Aaron* court to conclude that the SEC should be allowed to function with fewer impediments.[24] Therefore, the negligence standard, which suggests a

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21. The theory of aiding and abetting primary violations is beyond the scope of this note. *See* Comment, *Rule 10b-5 Liability after Hochfelder: Abandoning the Concept of Aiding and Abetting*, 45 U. CHI. L. REV. 218 (1977).

The 1933 Securities Act § 17(a), 15 U.S.C. § 77q(a) (1976), states in relevant part: "It shall be unlawful for any person in the offer or sale of any securities . . . (1) to employ any devise, scheme or artifice to defraud, 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."

The 1934 Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b) (1976), states in relevant part: "It shall be unlawful for any person . . . (b) To 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 . . ."

Rule 10b-5, 17 C.F.R. § 240.10b-5 (1979), promulgated by the SEC in 1942 pursuant to section 10(b), provides in relevant part: "It shall be unlawful for any person . . . (1) to employ any device, scheme or artifice to defraud . . . (3) to engage in any act, practice, or course of business which operates . . . as a fraud or deceit . . . in connection with the purchase or sale of any security."

For a background to these statutes and rule, see 3 L. LOSS, SECURITIES REGULATIONS 1683-1862 (2d ed. 1961); 6 L. LOSS, SECURITIES REGULATIONS 3820-4003 (2d ed. Supp. 1969).

22. 605 F.2d 612, 619 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66). *See* SEC v. Galaxy Foods, Inc., 417 F. Supp. 1225 (E.D.N.Y. 1976), *aff'd mem.*, 556 F.2d 559 (2d Cir.), *cert. denied*, 434 U.S. 855 (1977) (holding that a party should be viewed by his duties and responsibilities rather than title).

23. *Compare* SEC v. Blatt, 583 F.2d 1325 (5th Cir. 1978) (post-*Hochfelder* SEC enforcement actions requiring a scienter showing under section 10(b) and rule 10b-5) *and* SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226 (S.D.N.Y. 1976), *aff'd on other grounds*, 565 F.2d 8 (2d Cir. 1977) *with* SEC v. World Radio Mission, Inc., FED. SEC. L. REP. (CCH) ¶ 95,751 (1st Cir. 1976) (scienter not required) *and* SEC v. Shiell, FED. SEC. L. REP. (CCH) ¶ 96,190 (N.D. Fla. 1977) *and* SEC v. Geotek, 426 F. Supp. 715 (N.D. Cal. 1976).

Compare SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973) *and* SEC v. Pearson, 426 F.2d 1339 (10th Cir. 1970) *and* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc) (pre-*Hochfelder* SEC enforcement actions not requiring scienter for a section 10(b) and rule 10b-5 violation) *with* SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974) (scienter showing required).

lower burden of proof, should prevail over the *Hochfelder* scienter standard when the SEC brings suit under section 10(b) and rule 10b-5.

The appellate court further noted that the *Hochfelder* statutory analysis is not conclusive with respect to the issue.[25] The language of section 10(b) has been subjected to different judicial interpretations[26] and the legislative history of the section does not reveal a definite congressional intent.[27] The *Aaron* court reasoned that because section 10(b) can not be conclusively interpreted, section 21(d), as the source of SEC authority to seek injunctions, should be analyzed in detail. The *Aaron* court's analysis of the language and history of section 21(d) indicated that scienter was not an element in SEC actions for equitable relief.[28]

The appeals court additionally stated that because scienter was not required when the SEC brought suit under section 10(b), it would not be required for a section 17(a) action. *Aaron* cited *SEC v. Coven*,[29] which held that section 17(a) antifraud provision did not contain language comparable to the section 10(b) terms "manipulative and deceptive". Therefore, the *Hochfelder* statutory approach had no application to section 17(a).[30] The *Aaron* court did note that *Hochfelder* had not reached the scienter question under section 17(a), and the federal courts have been split on the issue since that Supreme Court decision.[31]

The *Aaron* court concluded that a permanent injunction was

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24. 605 F.2d 612, 621 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

25. *Id.* at 621-25. *See also Scienter After Hochfelder, supra* note 11, at 425-28 (author critical of the *Hochfelder* statutory analysis of section 10(b)).

26. 605 F.2d 612, 621 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66)).

27. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 404 U.S. 1005 (1971) (absent a clear legislative intent in regard to section 10(b), policy is controlling); Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967) (language of section 10(b) indicates that scienter is not required); Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961) (the language of section 10(b) implies a negligence standard absent definite congressional intent to the contrary).

The *Hochfelder* opinion stated that the 1934 Securities Exchange Act was "bereft of explicit explanation of Congress' intent." 425 U.S. 185, 201 (1976).

28. 605 F.2d 612, 621-23 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66) (the *Aaron* court reasoned that the policy considerations surrounding equitable actions should be crucial). The dichotomy between law and equity will be examined more fully in the text accompanying notes 53-81 *infra*.

29. 581 F.2d 1020 (2d Cir. 1978).

30. *Id.* at 1026-27.

31. *Compare* SEC v. American Realty Trust, 586 F.2d 1001 (4th Cir. 1978), *rev'g*, 429 F. Supp. 1148 (E.D. Va. 1977) (which had held that scienter was required) *and* SEC v. Southwest Coal & Energy Co., 439 F. Supp. 820 (W.D. La. 1977) (not requiring a showing of scienter for a section 17(a) action) *with* SEC v. Cenco Inc., 436 F. Supp. 193 (N.D. Ill. 1977) (scienter required).

properly issued against Peter Aaron. First, the court reasoned that the decision of the district court would not be set aside absent a clear abuse of discretion. Secondly, the appellate court relied on its previous holding that a permanent injunction was proper if the court determined that there is a reasonable likelihood that the wrong will be repeated.[32] The *Aaron* court further noted that since the district court found that Peter Aaron had acted with scienter,[33] the need for a permanent injunction was more compelling.[34]

ANALYSIS

A. Statutory Analysis

The analysis in *Hochfelder* began with the language of section 10(b) and rule 10b-5. A majority of the Justices concluded that the words "manipulative and deceptive" found in section 10(b) were clearly terms of art in the securities field requiring willful or intentional conduct.[35] Although the *Hochfelder* Court was clearly convinced that the language of section 10(b) connoted intentional misconduct, and that the plain meaning of a statute is controlling, the Court nevertheless proceeded to consider the legislative history of section 10(b).[36] Although explicit congressional statements on the question could not be found, the Supreme Court reached the same conclusion indicated by textual statutory analysis, that scienter was a required element in private actions under section 10(b).[37] Thus the Supreme Court by its

32. SEC v. Management Dynamics, Inc., 515 F.2d 801, 807 (2d Cir. 1975); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1100 (2d Cir. 1972).

33. SEC v. Aaron, FED. SEC. L. REP. (CCH) ¶ 96,043 at 91,685 (S.D.N.Y. 1977).

34. 605 F.2d 612, 623 n.16 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66). The *Aaron* court noted that its decision allowing liability for negligence rather than scienter, under sections 17(a), 10(b), and rule 10b-5, might not be conclusive. Quoting from Judge Friendly's opinion in SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 101 (2d Cir. 1978), the court stated "the final word will not rest with us." Perhaps the *Aaron* court was alluding to a future Supreme Court decision on the issue which *Hochfelder* had avoided.

35. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976). *But see* note 27 *supra*. However, the term "device," is also found in section 10(b) and has been viewed as requiring something less than actual intent. Armour Packing Co. v. United States, 209 U.S. 56, 71 (1908) (not a § 10(b) application).

36. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201-06 (1976).

37. *Id.* at 206. The Supreme Court supported its conclusion by stating that Congress had not specifically stated that scienter should not be required. *Id.* at 204. Furthermore, the Supreme Court stated that, in hearings before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 115 (1934), section 10(b) was described as a "catch all" clause to prevent manipulative devices, and that this conclusively indicated a non-negligence standard. *Id.* at 203-04. While this view may have merit, the lack of evidence of a specific congressional intent is crucial. For instance, the "catch all" statement well might suggest coverage of all forms of conduct, including intentional misconduct, recklessness, and negligence.

analysis clearly concluded that scienter was a required element in a proper cause of action for damages by a private party under section 10(b).[38] However, the *Hochfelder* Court specifically refused to consider the question whether scienter is a necessary element in an action by the SEC for injunctive relief under section 10(b).[39]

If the *Hochfelder* statutory analysis is conclusive then the SEC should be bound to the same standard under section 10(b) as would be a private party.[40] But other courts have not found the language of section 10(b) to be as clear as the *Hochfelder* Court viewed it regarding the scienter requirement.[41] The Supreme Court in *Addison v. Holly Hill Fruit Products, Inc.*,[42] stated that Congress' words, if susceptible to one meaning as well as another, should not stifle a policy by a pedantic or grudging process of construction.[43] While the *Hochfelder* Court felt certain that the language of section 10(b) clearly established the scienter equipment, the Court failed to consider the impact of such an analysis. The approach in *Hochfelder,* a private action for damages by a few investors, could severely compromise the efforts of the SEC to provide maximum protection to the investing public, if applied in actions initiated by that agency.[44]

The SEC as *amicus curiae* in *Hochfelder,* argued that the interdependent nature of the securities acts suggests that a negligence standard is sufficient for a private action under section 10(b).[45] Congress, in some sections, had set forth the specific mental state required for liability.[46] But the Supreme Court noted that legal actions under

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The *Aaron* court noted that it was not surprising that very little legislative history on the subject was found by the *Hochfelder* Court because a judicially created private right of action was being analyzed. 605 F.2d 612, 621 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

38. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976).

39. *Id.* at 193 n.12.

40. *See* note 11 *supra.*

41. *See* notes 26 & 27 *supra. See also* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971); Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967); Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961).

42. 322 U.S. 607 (1944) (dealing with a suit brought under the Fair Labor Standards Act).

43. *Id.* at 617.

44. SEC v. Shiell, FED. SEC. L. REP. (CCH) ¶ 96,190 at 92,386 (N.D. Fla. 1977).

45. Brief by SEC as *amicus curiae* at 23-33, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (noting that section 9 of the 1934 Act, 15 U.S.C. § 78i (1976), specifically requires willful conduct; therefore, because section 10(b) does not spell out the requirement, negligence should be sufficient).

46. Examples of explicit mental state requirements are: 1933 Securities Act § 11(a), 15 U.S.C. § 77k(a) (1976) (absolute liability for an issuer of securities for misleading statements contained in the registration statement); 1933 Securities Act § 11(b)(3)(B), 15 U.S.C. § 77k(b)(3)(B) (1976) (due diligence negligence standard for experts who are responsible for misleading statement in the registration statement); 1934

the provisions of the 1933 Act are subject to specific restrictions while the 1934 Act provisions are not similarly governed.[47] Thus the Supreme Court was reluctant to apply a negligence scheme to section 10(b) because that section is not subject to extensive procedural safeguards.[48]

The *Hochfelder* opinion concluded by suggesting that although SEC rule 10b-5 might be read to include negligent conduct, such an interpretation would not be supportable. Rule 10b-5 was derived and promulgated under the authority of section 10(b), and that section requires a scienter standard.[49]

Although it has a "certain technical consistency about it,"[50] the *Hochfelder* statutory analysis should be viewed as conclusive. It is drawn from incomplete views of congressional intent.[51] In addition, although the plain meaning analysis employed by the *Hochfelder* Court is viable, policy considerations should not be completely shunted aside in favor of mere words.[52]

B. The SEC: Origins and Function

Although the *Hochfelder* opinion is virtually devoid of policy discussion, such considerations were voiced by the SEC as *amicus curiae*.[53] Simply stated, to require the SEC to prove scienter rather than negligence will make it increasingly difficult for the SEC to perform its function under the securities laws.[54]

Indeed, the histories of the securities acts indicate that Congress intended to eliminate the abuses which contributed to the 1929 stock market crash.[55] The aims of the 1933 and 1934 Acts were to assure that

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Securities Exchange Act § 18, 15 U.S.C. § 78r(a) (1976) (liability for intentional conduct concerning misleading documents).

47. The procedural restrictions include section 12(2), 15 U.S.C. § 77l(2) (1976) and section 15, 15 U.S.C. § 77o (1976), both provisions requiring plaintiff to post bond. Section 13, 15 U.S.C. § 77m (1976), is subject to a one year statute of limitations.

48. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 211-12 (1976).

49. *Id.* at 214. In further support, the Court noted that rule 10b-5 was drawn up by the SEC in 1942 in order to prevent intentional misconduct. *Id.* It should be noted that the language of rule 10b-5 is very similar to the language used in section 17(a). *See* note 21 *supra* for the comparison.

50. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 216 (1976) (Blackmun, J., dissenting).

51. SEC v. Aaron, 605 F.2d 621 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

52. *Scienter After Hochfelder, supra* note 11, at 425-35.

53. Brief by SEC as *amicus curiae* at 11-12, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). The SEC cited to SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963), and argued that the purpose of the Securities Exchange Act of 1934 was to provide investors with the broadest possibile protection against false and deceptive practices.

54. SEC v. Shiell, FED. SEC. L. REP. (CCH) ¶ 96,190 at 92,386 (N.D. Fla. 1977).

55. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

full disclosure to prospective investors and purchasers would be made in order to provide for investor protection and, ultimately, to restore public confidence in the securities industry.[56] In order to effectuate these goals, the foremost aim of Congress was to avoid a strict, unworkable regulatory scheme which would impede their achievement.[57] The SEC was created by the 1934 Securities Exchange Act with these objectives clearly in focus.[58]

It is difficult to see, given the context in which the SEC was created, why that enforcement agency should be saddled with the difficult burden of proving scienter. A negligence standard would enable the SEC to function more flexibly within the framework of the securities laws and judicial review in order to provide, as Congress intended, maximum protection to the investing public.[59]

Because the SEC function encompasses the initiation of equitable actions, an analysis of the peculiarities of injunctive relief is in order. The Supreme Court in *Hecht v. Bowles*[60] stated:

> [t]he essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case. Flexibility rather than rigidity has distinguished it. The qualities of mercy and practicality have made equity the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims.[61]

At common law, a court in equity did not need proof that an actor knew that a representation made was false.[62] This was because it was thought that equitable remedies subjected a defendant to less harm

56. *SEC Civil Actions, supra* note 1, at 332-34. The author noted that the 1933 Securities Act sought to provide investors, through a registration process, with information necessary to make informed judgments as to new securities publically offered and to prohibit fraudulent and deceptive practices in the sale of securities. The 1934 Securities Exchange Act created the SEC to oversee the securities laws. The 1934 Act also sought to extend the full disclosure doctrine to securities sold on national exchanges. *Id.* at 329-30.

57. *Id.* at 335.

58. 605 F.2d 612, 622 n.14 (2d Cir.), *cert. granted*, 48 U.S.L.W. (1979) (No. 79-66). For an excellent discussion of the remedial purposes of the securities acts, see generally 1 L. LOSS, SECURITIES REGULATIONS 1-158 (2d ed. 1961); 4 L. LOSS, SECURITIES REGULATIONS 2201-94 (2d ed. Supp. 1969); *SEC Civil Actions, supra* note 1, at 329-35. *See also* SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973) (the purpose of the securities laws is to safeguard the public interest).

59. *SEC Civil Actions, supra* note 1, at 335.

60. 321 U.S. 321 (1944) (dealing with the injunctive powers of the Administrator of the Emergency Price Control Act of 1942).

61. *Id.* at 329.

62. The landmark English case of Redgrave v. Hurd, 20 C.D. 1 (1880), held that in equity the state of the actor's mind was irrelevant with respect to the representation made. *Id.* at 12-13.

than remedies at law.[63] Thus, a two-tier system evolved for misrepresentation: at equity, scienter was not required; at law, scienter was required.[64]

When Congress enacted the securities laws, it provided the SEC with the flexible equity tools found in sections 20(b) and 21(d).[65] As a consequence of the ease and speed with which an injunction can be obtained,[66] the SEC uses the section 10(b) and 21(d) provisions frequently and successfully.[67] When dealing with an SEC enforcement action, the courts have looked beyond section 10(b) to section 21(d) in order to determine the mental state required for liability.[68] While such an approach seems to be backward, because a violation of section 10(b) and rule 10b-5 invokes the 21(d) remedy, it nevertheless signifies the substantial hold equity has on the proceeding.[69]

In analyzing section 21(d) courts have looked at the language and legislative history of the provision.[70] The conclusion reached by those courts, and some legal scholars, is that Congress intended to follow the equity roots of the law. Thus, scienter should not be a requirement.[71]

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63. *Scienter After Hochfelder, supra* note 11, at 439-45.

64. *Id.* at 439. An application of this two-tier scheme in the securities field is found in SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). *See* text accompanying notes 89-93 *infra.*

65. *See* note 13 *supra* for the texts of these provisions. For a discussion of the creation of the SEC under the 1934 Securities Exchange Act, see generally 1 L. LOSS, SECURITIES REGULATIONS 129-58 (2d ed. 1961). For a discussion of the equity tools available to the SEC, see generally Note, *Equitable Remedies In SEC Enforcement Actions*, 123 U. PA. L. REV. 1188 (1975).

66. Note, *The Statutory Injunction As An Enforcement Weapon of Federal Agencies*, 57 YALE L. REV. 1023, 1025 (1948).

67. *SEC Civil Actions, supra* note 1, at 328. The SEC has a 92% success rate when bringing suits for injunctive relief.

68. 605 F.2d 612, 621-22 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66). *Accord*, SEC v. Dolnick, 501 F.2d 1279 (7th Cir. 1974); SEC v. Pearson, 426 F.2d 1339 (10th Cir. 1970).

69. Note, *Scienter's Scope and Application in Rule 10b-5 Actions: An Analysis in Light of Hochfelder,* 52 NOTRE DAME LAW. 925, 943 (1977); *Scienter After Hochfelder, supra* note 11, at 439-45. The argument is therefore made that the *Hochfelder* scienter requirement for section 10(b) does not apply when the SEC brings suit for injunctive relief.

70. 605 F.2d 612, 621-23 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

71. The wording of section 21(d), "any person is engaged or is about to engage in acts or practices," indicates that willful *conduct* is not a requisite element. *Id.* at 622 n.14. *See* note 13 *supra* for the text of section 21(d). The *Aaron* court undertook an analysis of the legislative history of section 21(d) and concluded that scienter is not required. *Id.* at 622 (citing to S. REP. NO. 75, 94th Cong., 1st Sess. 76 (1975), concerning the 1975 amendments to section 21(d)). Other courts have also recognized that the equity two-tier scheme has survived in present day securities regulation. *See, e.g.*, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). *But see* SEC v. Blatt, 583 F.2d 1325 (5th Cir. 1978) (scienter required under section 21(d)); SEC v. Coffey, 493

While some commentators have taken offense at this view,[72] it has been repeatedly held that an injunction under section 21(d) merely requires a showing of a reasonable likelihood that a wrong will be repeated.[73] Under this view, if the scienter element is found, it is relegated to consideration as but one of several factors which can be used to show the likelihood of a repetition of the wrong.[74]

The *Hochfelder* Court dealt with a private cause of action and, therefore did not consider the equity considerations associated with an SEC enforcement action.[75] Furthermore, the *Hochfelder* analysis appears to disregard all policy considerations surrounding securities regulation.[76] It would seem clear that *Hochfelder* should not apply to SEC injunctive actions because the Court dealt with neither equity nor the crucial policy considerations associated with securities regulation.[77] Because the firm equity basis of section 21(d) should preclude the burden *Hochfelder* might have placed on SEC actions,[78] and because securities law policy considerations should be considered in an SEC ac-

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F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975) (willful or reckless behavior required for an SEC enforcement action).

72. The offended commentators deal with the problem by looking at the severity of an injunction. *Scienter A Reappraisal, supra* note 5 (authors reason that an injunction is a powerful weapon and should be linked to a higher culpability standard); *SEC Civil Actions, supra* note 1 (author reasons that an injunction is not such a mild remedy when one considers the possibility of criminal or civil contempt charges for a violation of the injunction and, therefore, some purposeful activity should be required).

73. 605 F.2d 612, 623 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66). *Accord*, SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972).

74. 605 F.2d 612, 624 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66). (scienter found; underscores the need for an injunction) *See* note 100 *infra*. Comment, *Scienter and SEC Injunctive Suits*, 90 HARV. L. REV. 1018 (1977), cites several factors a court should consider when determining whether an injunction is proper: degree of scienter found; defendant's assurances that he will adhere to the law; defendant's expressions of innocence; extent of past violations and a possible pattern of such violations; personal gain for the defendant; and defendant's motivation for a repeat of such conduct.

75. 425 U.S. at 194 n.12.

76. *Id.* at 201-06. The *Hochfelder* opinion disregarded policy by considering the language of the statute as controlling. *See Scienter Under Rule 10b-5, supra* note 11, at 883.

77. SEC v. Shiell, FED. SEC. L. REP. (CCH) ¶ 96,190 (N.D. Fla. 1977), links the securities policy and equity considerations together by stating:

> [t]he purpose of an action for injunctive relief is to protect the public against injurious conduct, not to punish defendant's state of mind. To impose on the SEC the burden of providing deliberate dishonesty in an enforcement action could seriously hamper its ability to police securities transactions and thereby diminish the protection previously afforded the public.

Id. at 92,386. *But see* SEC v. Blatt, 583 F.2d 1325 (5th Cir. 1978).

78. Note, *Scienter's Scope and Application in Rule 10b-5 Actions: An Analysis in Light of Hochfelder*, 52 NOTRE DAME LAW. 925, 941-42 (1977).

tion for injunctive relief,[79] an equity analysis under section 21(d) should circumvent *Hochfelder*.[80] While the equity and policy analyses presented might appear to be conclusive, it is certainly debatable whether the Supreme Court will, in the future, disregard the result of the *Hochfelder* analysis of section 10(b) and more fully consider the implications of section 21(d).[81]

C. *The Term "Scienter"*

Much of the problem in the area of antifraud securities litigation centers on the uncertain and ill-defined terms used: scienter, recklessness, and negligence.[82] At common law, in the area of misrepresentation,[83] scienter is defined as the intent to deceive, mislead, or convey a false impression.[84] Intent is found when a representation is made without any belief as to its truth or with a reckless disregard of the truth.[85] This standard differs from a negligence standard in which a representation can be made with an honest belief in its truth, but because of a lack of reasonable care in ascertaining the facts or in the manner of expression, the speaker might nonetheless be considered at fault.[86] At common law, proof of actual intent is needed in an action

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79. *Scienter Under Rule 10b-5, supra* note 11, at 901.

80. *But see* note 72 *supra*.

81. Ironically, a possible prediction of future Supreme Court action came out of the Second Circuit in SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226 (S.D.N.Y. 1976), *aff'd on other grounds*, 565 F.2d 8 (2d Cir. 1977). The case dealt with a phone conversation and alleged deceptions during that conversation. The district court concluded that *Hochfelder* applied to SEC actions as well. In doing so, the court disregarded the line of Second Circuit negligence holdings for SEC actions and, on the contrary, proceeded under the Second Circuit's line of private action cases requiring scienter. The court read *Hochfelder* to include reckless behavior.

Attorneys for Peter Aaron argued that the *Bausch & Lomb* decision may have implicitly changed the law in the Second Circuit. Brief for Appellant at 40, SEC v. Aaron, 605 F.2d 612 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66). While *Aaron* is clearly distinguishable from *Bausch & Lomb*, it is nevertheless significant with respect to the Second Circuit's negligence stand that such a conflict should occur within the circuit.

82. *See* 3 L. LOSS, SECURITIES REGULATIONS 1432 (2d ed. 1961); Bucklo, *Scienter and Rule 10b-5*, 67 NW. L. REV. 562, 564-75 (1972).

83. An action for intentional misrepresentation required: an intent that a representation be made; that the representation be directed to a particular person or class of persons; that the representation convey a certain meaning; and that the representation be believed and acted upon in a certain way. W. PROSSER, THE LAW OF TORTS § 107, at 700 (4th ed. 1971). For the purposes of this note, misrepresentation encompasses the old action of deceit when an intent to mislead has been established. *Id.* § 105, at 684-86.

84. *Id.* § 107, at 700.

85. *Id.* at 701.

86. *Id.* at 704.

for intentional misrepresentation, and negligence alone is not sufficient for liability.[87] The proof difficulties for intentional misrepresentation are more substantial than for negligence because the actor's subjective state of mind is crucial to a finding of intent.[88]

In the area of securities regulation, however, the general consensus among commentators[89] and the courts[90] is that the strict common law scienter requirement for an action in misrepresentation, if applied to an action under the securities laws, would act to deter achievement of the remedial purposes of the securities laws. The Supreme Court led the way in the gradual erosion of the common law in *SEC v. Capital Gains Research Bureau, Inc.*,[91] by holding that in an action for equitable relief, the SEC need not show all the technical elements of common law fraud.[92] The *Capital Gains* Court dealt with the Investment Advisers Act of 1940 and reasoned that requiring the SEC to prove scienter or the actual intent to deceive would undermine the remedial effects of that securities act.[93]

The *Hochfelder* Court concluded that under section 10(b) and rule

87. *Id.* at 701. The landmark English case of Derry v. Peek, 14 App. Cas. 337 (1889), was responsible for this two-tier view of misrepresentation by holding that in an action for deceit scienter was a necessary element.

88. In K. BIALKIN, THE 10(b) SERIES OF RULES 9 (1975), the author further states that the common law deceit action has little utility in securities transactions.

89. In 3 L. LOSS, SECURITIES REGULATIONS 1766 (2d ed. 1961), Loss recognizes a need for some watered down scienter requirement under rule 10b-5 and believes that the out-moded common law view should not control. In K. BIALKIN, THE 10(b) SERIES OF RULES 15 (1975), Bialkin states that scienter has lost its meaning and, therefore, negligence should suffice when the SEC brings suit for injunctive relief.

In opposition, the authors of *Scienter A Reappraisal, supra* note 5, believe that *Hochfelder* requires a showing of actual intent when the SEC brings suit. It should be noted that the authors, Berner and Franklin, represented Ernst & Ernst in *Hochfelder*.

90. White v. Abrams, 495 F.2d 724 (9th Cir. 1974) (common law elements of fraud should be modified in order to accomplish the congressional purposes); Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973) (en banc) (scienter liberally defined as willful, deliberate or reckless disregard of the truth that is merely equivalent to actual knowledge).

91. 375 U.S. 180 (1963).

92. *Id.* at 192-94. *Accord*, Affiliated UTE Citizens v. United States, 406 U.S. 128 (1972).

93. 375 U.S. at 195. The reasoning used in *Capital Gains* has been applied to section 17(a) of the 1933 Act and section 10(b) of 1934 Act by lower federal courts. *See, e.g.*, SEC v. World Radio Missions, Inc., FED. SEC. L. REP. (CCH) ¶ 95,751 (1st Cir. 1976); SEC v. Spectum, Ltd., 489 F.2d 535 (2d Cir. 1973); SEC v. Pearson, 426 F.2d 1339 (10th Cir. 1970).

But cf. Scienter A Reappraisal, supra note 5 (authors state that *Capital Gains* should not extend to section 10(b) since the reasoning employed was directed at the Investors Advisers Act of 1940); *Scienter Under Rule 10b-5, supra* note 11 (author states that the *Capital Gains* decision did not adequately spell out what the required state of mind is, thus decreasing the value of the opinion as support for the negligence position).

10b-5, in a private cause of action, scienter or the intent to deceive, manipulate or defraud must be shown.[94] Thus, by the words used in *Hochfelder*, it would appear that a return to the common law had been effectuated.[95] However, the *Hochfelder* scienter definition has been read by courts and commentators to include lesser degrees of culpability, than required at common law, for a section 10(b) and rule 10b-5 private cause of action.[96] If this course towards a lesser standard of culpability is followed then the harsh effects of *Hochfelder* in this area of the law may be mitigated.[97]

The crucial difference, however, between an SEC and a private action still stands. SEC enforcement actions are brought to afford the investing public maximum protection while private actions for damages primarily provide monetary relief to individual investors.[98] The *Aaron*

94. 425 U.S. at 193.

95. While the *Hochfelder* decision makes few references to *Capital Gains*, the opinion cites to *Capital Gains* in reference to the Supreme Court's refusal to consider the scienter requirement in a SEC enforcement action. *Id.* at 194 n.12. Perhaps the *Hochfelder* Court was signaling that a future decision involving the SEC would rely on *Capital Gains* as precedent. If this is the case, the SEC would probably not be required to show scienter for a section 10(b) action. Furthermore, the *Hochfelder* opinion noted that in certain areas of the law the term scienter encompassed reckless behavior. The Court, however, refused to rule on the issue. *Id.* at 194 n.12.

96. The cases that have taken this expanded view of the *Hochfelder* scienter standard include, SEC v. Cenco Inc., 436 F. Supp. 193 (N.D. Ill. 1977) (scienter under *Hochfelder* includes recklessness or a highly unreasonable omission involving not merely simple, or even inexcusable negligence, but an extreme departure from ordinary care), and SEC v. Wills, FED. SEC. L. REP. (CCH) ¶ 96,102 (D.D.C. 1977) (scienter liberally construed to include reckless behavior). The positions taken by these courts qualify the potential harsh effect *Hochfelder* might have had on SEC enforcement actions. This, however, does not solve the problem. *See* notes 97-100 *infra*.

Various commentators have also spoken on the issue. In Bucklo, *Scienter and Rule 10b-5*, 67 NW. L. REV. 562 (1972), the author stated that scienter is an illdefined and overused term that should be construed to mean actual or constructive knowledge. *Id.* at 571. Furthermore, while the author notes that a negligence standard may be harmful to the defendant, crucial policy considerations for investor protection suggest a negligence scheme for SEC enforcement actions. *Id.* at 594. In Bucklo, *The Supreme Court Attempts to Define Scienter Under Rule 10b-5: Ernst & Ernst v. Hochfelder*, 29 STAN. L. REV. 213 (1977), the same author concluded that the *Hochfelder* opinion seemed to include acts of recklessness under its definition of scienter. *Id.* at 219-20. *See also Scienter Under Rule 10b-5, supra* note 11, at 932 (scienter standard should not be rigid, but should be limited to the particular circumstances); Comment, *Rule 10b-5 Liability after Hochfelder: Abandoning the Concept of Aiding and Abetting*, 45 U. CHI. L. REV. 218 (1977) (given the difficulties in determining the actual state of mind, lesser degrees of culpability should be read into the *Hochfelder* decision).

97. An expansion of the scienter term to include lesser degrees of culpability will certainly help to mitigate the harsh effects that *Hochfelder* has on private plaintiffs in actions brought under section 10(b). But even a recklessness standard is viewed as too restrictive when the SEC brings suit. *See* note 99 *infra*.

98. 605 F.2d 612, 621 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

case, in particular, and the case law of the Second Circuit, generally, do not seem amenable to a higher standard for culpability.[99] Clearly, while scienter in some form or degree may be shown in the Second Circuit to establish liability in SEC injunctive actions, negligence is the controlling standard in that it is sufficient.[100]

Therefore, while *Hochfelder* can be read to include lesser degrees of culpability, and many commentators reason that scienter also at least includes reckless behavior, this is still quite distant from the negligence standard set forth in *Aaron*.

CONCLUSION

Justice Blackmun, dissenting in *Hochfelder*, stated: "[i]t seems to me, however, that an investor can be victimized just as much by negligent conduct as by positive deception, and that it is not logical to drive a wedge between the two, saying that Congress clearly intended the one but certainly not the other."[101] While Justice Blackmun was arguing for a negligence standard for private parties, his reasoning centered on the need to provide maximum protection to the public, regardless of the identity of the party bringing suit. The scienter standard as set forth in *Hochfelder*, Blackmun concluded, would thwart needed relief for investors and would ultimately cause Congress to directly deal with the dilemma.[102]

Therefore, the position taken by the Second Circuit, recently affirmed in *SEC v. Aaron*,[103] should not falter in light of *Hochfelder*[104] and other Supreme Court decisions geared to limiting private access to the securities laws. The SEC is not a private party and the standards used to evaluate and control it need not be identical to those applicable to private parties. The inconclusive *Hochfelder* analysis must, therefore, not override or impede the important function of the SEC in

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99. *Id.* at 622-24 (negligence alone is sufficient when the SEC brings suit under sections 10(b) and 21(d)). *Accord*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971). The reader is reminded that the Second Circuit is considered a leader in the area of securities law. *See* note 8 *supra*.

100. 605 F.2d 612, 623-24 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66 (scienter found relevant in determining only whether an injunction is appropriate). *Accord*, SEC v. Universal Major Indus. Corp. 546 F.2d 1044 (2d Cir. 1976), *cert. denied*, 434 U.S. 834 (1977); SEC v. Spectum, Ltd., 489 F.2d 535 (2d Cir. 1973); SEC v. Galaxy Foods, Inc., 417 F. Supp. 1225 (E.D.N.Y. 1976), *aff'd*, 556 F.2d 559 (2d Cir. 1977). *But see*, SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226 (S.D.N.Y. 1976), *aff'd on other grounds*, 565 F.2d 8 (2d Cir. 1977). *See* note 81 *supra*.

101. 425 U.S. at 216 (Blackmun, J., dissenting).

102. *Id.* at 218.

103. 605 F.2d 612 (2d Cir.), *cert. granted*, 48 U.S.L.W. 3258 (1979) (No. 79-66).

104. 425 U.S. 185 (1976).

securities regulation. The courts should not burden the SEC with a higher culpability standard under section 10(b).

The direction of the law to include reckless behavior under the *Hochfelder* scienter requirement does not appear satisfactory. Such a standard would still burden the SEC by requiring it to show and prove subjective elements related to the defendant's state of mind. A negligence standard would obviate this requirement, and set a minimum culpability level with which the SEC could better further the purposes and policies of the securities laws.

The need for adequate securities regulation today has not diminished since the securities laws were enacted and the role of the SEC should, therefore, not be made more burdensome by requiring the SEC to prove scienter in an action for injunctive relief. The SEC must be allowed to function flexibly in order to protect the public and the securities industry. The two-tier equity scheme which does not require a showing of scienter in a common law action for misrepresentation, and the policy considerations underlying the securities laws, should be the bulwarks against the imposition of a scienter requirement in SEC enforcement actions.

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