ORIGINAL

In the

Supreme Court of the United States

PETER E. AARON, Petitioner,	)	
v.	)	No. 79-66
SECURITIES AND EXCHANGE COMMISSION, Respondent.	)	

Washington, D.C.
February 25, 1980

Pages 1 thru 38

Hoover Reporting Co., Inc.
Official Reporters
Washington, D. C.
546-6666

IN THE SUPREME COURT OF THE UNITED STATES

PETER E. AARON, Petitioner, v. SECURITIES AND EXCHANGE COMMISSION, Respondent.	No. 79-66

Washington, D. C.,

Monday, February 25, 1980.

The above-entitled matter came on for oral argument at 1:50 o'clock p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

BARRY M. FALLICK, ESQ., 230 Park Avenue, New York, New York 10017; on behalf of the Petitioner

RALPH C. FERRARA, ESQ., General Counsel, Securities and Exchange Commission, Washington, D. C. 20549; on behalf of the Respondent

- - -

C O N T E N T S

- - -

P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in 79-66, Aaron v. Securities and Exchange Commission.

Mr. Fallick.

ORAL ARGUMENT OF BARRY M. FALLICK, ESQ.,

ON BEHALF OF THE PETITIONER

MR. FALLICK: Mr. Chief Justice, and may it please the Court:

This matter concerns an appeal from the Court of Appeals for the Second Circuit which affirmed a judgment of the District Court which had permanently enjoined the petitioner from violating the anti-fraud provisions and the registration provisions of the Securities Acts of 1933 and 1934.

The issue that is raised in this appeal is whether scienteris a necessary element in an action for injunctive relief under section 10(b) and Rule 10b-5 and under Section 17(a) of the 1933 Act.

The facts surrounding the issuance of the permanent injunction are quite short and simple. Petitioner was employed by a company known as E. L. Aaron & Company, a company owned by his father. From 1974 through the beginning of 1975, E. L. Aaron & Company was making a market in the common stock of a company known as Lawn-A-Mat Chemical & Equipment Corp. During that period of time, a branch office

was opened in Roslyn Heights, New York. Two registered employees of E. L. Aaron & Company sent to that branch office and during their time there they made misrepresentations concerning the financial status and health of Lawn-A-Mat and also concerning future manufacturing ideas concerning Lawn-A-Mat.

The District Court, while finding that Mr. Aaron did not make any false misrepresentations, nevertheless said he willfully aided and abetted a violation of the anti-fraud provisions by failing to prevent his employees from continuing in those statements they made. Of course, Mr. Aaron was not an owner of E. L. Aaron & Company, nor was he an officer of E. L. Aaron & Company.

The Second Circuit Court of Appeals nevertheless said that it did not have to reach the issue of scienta and based on its long-term policy said that the standard in injunctive actions under section 10(b) would be a negligence standard. Thus, the first issue was whether under section 10(b) there should be a standard of scienter in injunctive actions.

QUESTION: Mr. Fallick, in your question presented for decision in your petition for certiorari, when you refer to the government enforcement by injunction of these acts, do you think there is fairly assumed the federal rules of civil procedure, 65 et cetera, relating to

injunctions, regardless of whether the particular statutes contain a requirement of scienter or not when enforcement is brought by the government?

MR. FALLICK: Well, standards under the sections concerning injunctive relief, whether the defendant is engaged or likely to engage in a violation of certain sections or regulations of the securities law, and I am not quite sure if that is the same standard under the federal 65.

In the Hochfelder case, this Court had the opportunity to construe the meaning of section 10(b) in the context of a private damage action. We submit that there is nothing in that Court's decision which indicates that a different standard should be applied here.

In Hochfelder, this Court relied on the language, legislative history and administrative history of section 10(b) to determine that that language connotes intentional conduct. Of course, when section 10(b) was enacted, Congress did not contemplate that there would be a private damage cause of action, therefore the language and the history should reflect congressional determination and intention concerning injunctive relief under section 10(b).

The government relies heavily on the Capital Gains case in which this Court in 1940 stated that there is a difference between fraud in law and fraud in equity. In that case, Capital Gains, Mr. Justice Goldberg heavily

relied upon the legislative history surrounding the Investment Advisers Act, and this Court has said that that interpretation is premised on congressional belief that there should be standards concerning federal fiduciary relationship with investment advisers.

In addition, Mr. Justice Goldberg was clearly influenced by the fact that the injunctive relief in Capital Gains was mildly propylactic. Here, however, in the normal course of security business, injunctive relief is no longer considered mildly prophylactic. There is a loss of reputation, a loss of business, subject to administrative and criminal proceedings.

Courts no longer, especially in the Second Circuit, consider injunctive relief to be mildly propylactic. Thus, because the statutory text of Capital Gains is of course different than under 10(b), because of the legislative history of the Investment Advisers Act, and because of the premise that injunctive relief is mildly propylactic, and it was in that case. That case was clearly distinguishable from the case at bar.

There is also an issue presented here concerning whether injunctive relief should be premised on a standard of scienter under section 17(a) of the 1933 Securities Act. Several courts, several commentators have recently commented upon section 17(a). The Fifth Circuit, in construing

subsection (1) of 17(a), said the language there, especially the words "device, scheme and artifice to defraud" clearly connote that Congress intended that a standard of scienter be established.

Of course, the Fifth Circuit in the Steadman case was relying on the language of this Court in Hochfelder.

The petitioner takes the position that whatever standard, especially it should be a scienter standard, is established under 10(b), it should also govern under section 17(a). These two sections are so closely related, they both serve the same function, that it is cleasr that congressional intent should be that the language should be construed to establish that the standard of liability for injunctive relief under 10(b) is a scienter standard.

QUESTION: Although 17(a)(2) of the 1933 Act does not by its terms either explicitly or implicitly indicate a requirement of scienter, does it?

MR. FALLICK: By its terms, no, it does not. In fact --

QUESTION: Unlike 10(b)(5) as at least as construed in the Hochfelder case.

MR. FALLICK: 10(b)(5) is, of course, relying upon its promulgating statute which would be 10(b).

QUESTION: 10(b), yes.

MR. FALLICK: 17(a) stands alone. However, it is

our position, because the language of 17(a) is so similar to that of 10(b) and 10(b)(5) and the statutes serve the same function, that using the --

QUESTION: Well, my question was whether -- isn't the language of 17(a)(2) different from that of 10(b).

MR. FALLICK: It is different from 10(b), similar to 10(b)(5) and the Investment Advisers Act 206. While it is different, we contend that it should have the same standard of scienter, otherwise we will be an anomaly between the '33 Act and the '34 Act concerning the standard of liability.

QUESTION: Well, there are other differences between the two acts.

MR. FALLICK: There are other differences --

QUESTION: They have different purposes.

MR. FALLICK: The differences are, of course, different but --

QUESTION: But they are in the same ball park, of course.

MR. FALLICK: The two measures are both general anti-fraud measures concerning deceptive sales.

QUESTION: Right.

MR. FALLICK: I would like to reserve the rest of my time.

MR. CHIEF JUSTICE BURGER: Very well.

Mr. Ferrara.

ORAL ARGUMENT OF RALPH C. FERRARA, ESQ.,

ON BEHALF OF THE RESPONDENT

MR. FERRARA: Mr. Chief Justice, and may it please the Court:

The Securities and Exchange Commission believes that in an enforcement action brought by the commission, when a federal District Court judge finds that a defendant has engaged in conduct which has deceived the public in connection with a securities transaction and he finds that unless enjoined the defendant is likely to continue to engage in that conduct, he may grant injunctive relief without showing that the defendant acted with scienter. In short, the --

QUESTION: What do you mean by "deceived"?

MR. FERRARA: Well, in the federal securities laws, what is prohibited in section 10(b) of the Securities and Exchange Act is the employment of a deceptive device. Deceptive in that context is an effect word that reaches for the effect of the misconduct on the investor. If the investor has been misled, then he has been deceived and it is actionable, we would submit, under section 10(b). Is that --

QUESTION: Does he not require any -- it is simply the making of a statement which is not true without regard

to the knowledge on the part of the person making the statement as to whether or not it was true?

MR. FERRARA: Now, you have to sort between both acts, Mr. Justice Rehnquist, the Securities Act and the Exchange Act. Under section 10(b), the section that I began with, the commission would submit that a deceptive act may be enjoined by a federal District Court judge if he finds that it is likely to recur. The fact that somebody has engaged in the past in a deceptive act is for purposes of a commission action not significant. Remember, the commission's injunctive action under section 10(b) is predicated upon a showing that a defendant is engaged or is about to engage in a violation of any of the sections of the Exchange Act.

So what the commission need show is that someone has engaged in misconduct which is reasonably likely to deceive, reasonably likely to reoccur, and then a federal District Court judge, exercising his discretion, may enter an injunction.

The question of the defendant's subjective state of mind doesn't enter into the question of whether or not a deception has occurred. That is what section 10(b) speaks to.

QUESTION: Well, Hochfelder, of course, held that that language, deception, artifice and scheme, that those words were not effect words but that they were purpose

words. So your submission must be that they mean something different when it comes to injunctive relief.

MR. FERRARA: That is absolutely correct. In Hochfelder, the majority opinion of the Court stated with near surgical precision the context within which that case was going to be decided, namely whether or not scienter was going to be required in a private action for money damages under section 10(b), and in that context --

QUESTION: In any event, a lot of the reasoning of the opinion was that those words were purpose words, intent words, not effect words.

MR. FERRARA: The reasoning in Hochfelder was that they were intent words in the context of that case, and that was quite appropriate in Hochfelder because in a private damage action, Mr. Justice Stewart, the real issue for the plaintiff is to demonstrate that the defendant has engaged.

QUESTION: Wrong doing.

MR. FERRARA: And once there is a determination that the defendant has engaged, then monetary relief assuming causation and the other requirements follows. That is a much different legal context than when the commission brings an action for injunction. In that context, the word "deception" -- not deceive, recall section 10(b) does not proscribe deceit, it prescribes deceptive practices or deceptive devices -- in that legal context, we think the

language of section 10(b) takes on a shade of different meaning.

And I might add, Mr. Justice Stewart, there is nothing strange to the law and the canons of statutory construction, this Court has found that to be the case before. SEC v. National Securities, for example, comes to mind, an opinion in which, as I recall it, you concurred in part and dissented in part. In that opinion, writing for the majority of the Court, Mr. Justice Marshall commented that the word "sale" could take on different meanings in the context of the registration provisions and the anti-fraud provisions of the Securities Act. In doing that, Mr. Justice Marshall noted that even Congress had intended in the definitional sections of the Securities Act that the words listed in there should have the meaning stated unless the context otherwise required. And if my recollection serves me correct, you dissented in part from that portion of Mr. Justice Marshall's opinion, writing for the majority, but even in that dissenting footnote I think you said while definitional problems are reasonably related in private actions and in SEC enforcement actions, it is not plainly inconsistent to give different shades of meaning because of the different context within which those two actions arise.

So the position that the commission is taking here is consistent with principles of statutory construction I

think that this Court has utilized in prior cases generally and in prior securities cases specifically.

QUESTION: Isn't there something of a tradition built up around the first part of this century against what is called government by injunction, that is that it is easier for the government to go out and get an injunction against a person not requiring intent, simply enjoining them from disobeying the law and then prosecuting them on a civil contempt standard when they disobey a law, rather than bringing what might otherwise be a criminal prosecution against them?

MR. FERRARA: Your question raises several subquestions. Let me try to deal with each. First, is there a bias or was there a bias at common law at the turn of the century against governmental injunctive actions. We would also --

QUESTION: In a contempt setting, counsel, is it not necessary to show scienter before a contempt order could be entered and sustained?

MR. FERRARA: Mr. Chief Justice, the answer to your question is yes, but it is a slightly different question than the one that Mr. Justice Rehnquist asked me.

QUESTION: I was taking it one step beyond his.

MR. FERRARA: Mr. Justice Rehnquist asked the question of whether or not civil contempt would be an abuse

of governmental process, and you've asked the question of whether criminal contempt should lie without a showing of intentional or wreckless misconduct. The answer to Mr. Justice Rehnquist's question is civil contempt may lie. Recall that civil contempt is contempt that is imposed by the court to require the offending party to engage in an affirmative act. There, for example, if a party was enjoined by the court to file an updated report with the commission and he refused to do so, then civil contempt would lie.

Mr. Chief Justice Burger's question is would criminal contempt lie. That raises a slightly different context. Criminal contempt --

QUESTION: Mr. Ferrara, let me ask you, it seems to me that you ought to go back to the beginning of the case. If you are going to bring an injunctive action, you are going to -- by the time you have served your complaint, the defendant is going to be put on notice as to what he has done. He has already known what he has done all right and he knows that the government is going to claim that he has misled somebody.

MR. FERRARA: That's correct.

QUESTION: And if you can show that after knowing that, after knowing that that he is about to do it again, he is never going to be able to say that he didn't intend

to mislead somebody.

MR. FERRARA: Well, I think after the filing of the --

QUESTION: And if he disobeys an injunction obtained after that kind of a showing, courts have to have some way of enforcing their injunction. I would suppose they could.

MR. FERRARA: That's correct. That I think is the heart of the Chief Justice's question. Criminal contempt usually lies when someone has violated the terms of a prohibitory injunction, and that I think is different than civil contempt.

I think Mr. Justice White's question goes to the issue of not whether or not contempt would lie against a defendant after a complaint has been brought, because contempt will only lie once an injunction has been entered, but rather whether or not perhaps additional proceedings might be warranted against that --

QUESTION: Well, my suggestion to you is that by the time you get to the end of your injunction case, you will have satisfied the --

MR. FERRARA: That's right.

QUESTION: -- the Hochfelder standard.

MR. FERRARA: Well, assuming that his conduct is continuing, that's correct.

QUESTION: All right. If you can show that he is about to do it again and you've already told him that he has misled somebody and you have proved it by definition --

MR. FERRARA: That's absolutely correct.

QUESTION: Then I don't know why you don't say the standards are different. They are the same in both cases. The only thing is that you satisfy the Hochfelder standard in putting on your injunction case.

MR. FERRARA: At times you -- if the conduct is actually in progress while the injunctive case is pending -- but I would agree with you, you satisfy the Hochfelder standard. But if the conduct is retrospective conduct, if it has been concluded that it is a past violation, then what the commission needs to still show, not just a past violation but a reasonable likelihood of recurrence.

QUESTION: I know, but --

MR. FERRARA: If the defendant is quiescent during that period --

QUESTION: Yes, but if you show that he is likely to do it again, it seems to me that automatically if he does it again he will be doing it knowingly.

MR. FERRARA: If he does it --

QUESTION: Because you have already -- you've got him into court, you said here is what you did, here is why it was wrong, here is how it misled somebody.

MR. FERRARA: I agree with that.

QUESTION: What about the caseof someone who is charged with simple negligence and you've made out your case of simple negligence, and now you are trving to show that he is apt to violate the act by simple negligence again. That is quite a difficult showing to make.

MR. FERRARA: It is indeed, and the commission --

QUESTION: What if he makes it, what if you make it?

MR. FERRARA: Well, let me respond to both questions, if I may. Unquestionably if all the commission is able to show is that someone has failed to use due care or, conversely, has been careless in making a misstatement in one individual isolated instance, then we think it would be perhaps unlikely that a federal District Court judge applying general equitable principles applicable to situations such as this would order an injunction because a federal District Court judge has broad discretion, takes many factors into account besides the culpability of the defendant in order the injunction.

Now, Mr. Justice White's question is let's assume that the commission meets that standard, let's assume that we show not only culpability but also other factors --

QUESTION: Well, he can't do it negligentlv again if he has been told. You can't be careless, he's been told.

MR. FERRARA: If he does not do it negligently again, then we think criminal contempt could lie because the injunction has put him very specifically on notice as to what his misconduct was.

QUESTION: And you've been able to convince the judge that to get your injunction that he is liable to perform this action again. That's the only way you are going to get your injunction.

MR. FERRARA: That it is reasonably likely that he is to perform the act again, that's correct.

QUESTION: And if he does, he can hardly complain or defend on the ground that his second performance was careless.

MR. FERRARA: He -- well, we would hope that he would hardly be able to contend that, but in the context of a criminal contempt the question raised by the Chief Justice is he presumably would go into the criminal courts saying at best I was careless the second time, I didn't violate the terms of the decree --

QUESTION: That is a question of contempt, not of securities law.

MR. FERRARA: That's correct.

QUESTION: In this case, if he was negligent in simply failing to supervise his employees, if the government says you still have a lousy operation, you haven't got your

house in order and your employees are running around, would you say that in response to Mr. Justice White's question that the government has made out a scienter standard or just a likelihood to again continue to be negligent?

MR. FERRARA: Well, the government at that point would have two options to pursue. One, it could seek criminal contempt against the defendant demonstrating that because he has been specifically put on notice by the prior injunction in an admonitory way that his conduct violates the law, that the second time he is engaged willfully or knowingly in a violation of the federal securities laws, contempt will lie. Or the commission alternatively could go back against the same defendant, demonstrating that the conduct wasn't knowing but that was negligent and that perhaps further judicial relief is appropriate.

The key I think to the commission's position on this case is not that the commission intends to go out and to willy-nilly issue or ask courts to issue injunctions against people who have done nothing more than fail to exercise due care. To the contrary, though, the commission's position is, again, once someone -- once a federal District Court judge makes determination that someone has engaged in misconduct which has resulted in a deception and is reasonably likely to recur, that federal District Court judge should not be powerless to enter an injunction.

Now, if the conduct that the commission demonstrates is in fact intentional conduct or scienter, as used in the Hochfelder case, then I think, Mr. Justice Rehnquist, there is a very high likelihood that the federal District Court judge will enter the injunction.

If, on the other hand, the defendant's conduct was singular and wholly faultless, drawing on a term from the Hochfelder opinion, then it is far less likely that a federal District Court judge would utilize his discretion to enter the injunction. And in that gray area of what runs between wholly faultless conduct and intentional conduct -- and I suppose there are gradations there of culpability which include gross negligence, recklessness, knowing conduct, scienter, intentional conduct, willful conduct, and so on -- depending on the gradation that the commission demonstrates, I think you increase the likelihood that an injunction will be entered.

Again, it is critical to keep in mind that for the commission's case, as opposed to a private action, the substantive provision, 10(b), and the authorization to seek an injunction, 21(d) of the Exchange Act, actually have to merge. Merely proving a past violation doesn't get you there, and that is what distinguishes this case from Hochfelder, and that is the extraordinarily different legal context in which this case is presented, the context that

requires that injunctions be issued not be precluded absent a showing of scienter.

Mr. Justice Blackmun, I think you will note in the comment that I just made perhaps somewhat of a response to a comment you made in your dissenting opinion in Hockfelder, that the action should not depend upon the identity of the plaintiff. The commission continues to agree with that.

The commission's position here is that the operation of section 10(b) doesn't depend on whether the plaintiff is the commission or a private party. The distinction depends upon the nature of the action, the totally different legal context of an equitable action versus an action for money damages, which I might add is consistent with the issue that was reserved in the Hochfelder opinion in Footnote 12. Recall, the majority opinion in Footnote 12 of Hochfelder specifically reserved the question of whether scienter need be shown in an injunctive proceeding under section 10(b) or rule 10(b)(5). It didn't reserve the question necessarily of whether an SEC enforcement proceeding need not show scienter. It is the quality, the character, the nature of the proceeding that makes the coloration of the words, the interpretation of the words, the statutory construction principles that are applicable different, not the identity of the plaintiff.

Well, if I may, I have covered a good many of the

things that I wanted to talk on today, but perhaps I could spend a moment or two detailing some of the other considerations that the commission would like to bring to bear on this question.

First, picking up and continuing on this thread of the need for the commission to proceed without an absolute showing of scienter in its injunctive actions, I think that to fail to do so would really fail to recognize some very important distinctions that are -- and standards of culpability that are included in other provisions of the Securities and Exchange Act. For example, in other governmental proceedings the Congress very carefullv chose words of culpability, willfully, reasonable care, good faith, reasonable grounds to believe, purpose, and so on. Those words we think are peculiarly absent from section 10(b). They are also absent from the provisions that authorized the commission to bring its injunctive proceedings. That is important, and the reason it is important is because Congress in defining the array of enforcement powers that the commission has used those words of culpability in other specific provisions.

For example, the commission has various enforcement alternatives available to it. One of those enforcement alternatives is an administrative proceeding. There Congress reached and used a specific word of culpability,

willfully. The commission also, working with the Department of Justice, can refer a case for criminal prosecution, another specific remedy provided to the commission. There the Congress also chose another very specific word of culpability, willfully. This we don't think was inadvertent, that in the final section of the act -- not the final, but another section of the act, authorizing the commission to seek injunctive relief, the Congress specifically declined to use standards of culpability but, rather, used a different locution. The Congress chose to say the commission can seek an injunction upon a proper showing, so the Congress moved from words of culpability to burden of proof problems, different concept.

QUESTION: Mr. Ferrara, in section 10(b) of the '34 Act, with respect to the words "manipulative, deceptive and contrivance," would you say that any of those implied any state of mind or culpability?

MR. FERRARA: Well, again, Mr. Justice Rehnquist, it depends upon the context within which the case arises. In an equitable --

QUESTION: Well, taken in the context in which Congress enacted them.

MR. FERRARA: Well, again -- I can take them in the context in which Congress enacted them, and that --

QUESTION: Well, that is what we usually do,

isn't it?

MR. FERRARA: -- and that context recognized that common law, this very distinct division between actions at fraud at law and actions at fraud and equity. Congress realized that at the time, so that is the context. In that context, the word "manipulative" does take on an actions at law, money damage actions, an intent connotation and an intent character. In a commission injunctive action at equity, if the effect of the action is manipulative, perhaps the commission should be able to seek an injunction.

Also manipulative, when used in the Exchange Act, is indeed a word of art, as Mr. Justice Powell noted in his majority opinion in Hochfelder. But that word of art doesn't only cover the wash sales, the matched orders, the kinds of manipulation, classic manipulation that I think the Court was referring to in the context of that case. The context, again following up with your question, the context is manipulative when you look, for example, at section 9(a)(4) of the Exchange Act, contained in the general manipulative section, also reaches false statements for the purpose of inducing a person to purchase or sale of a security on an exchange, all wrapped within the concept of manipulation, the context within which Congress intended those words to be used.

When you get around to your other two words,

device and contrivance, first there is nothing in those two words themselves that necessarily connote a form of intentional misconduct. I agree that Webster's -- when you read the Webster definitions of device and contrivance, there is that -- you can read in that element of intent, but I can note for you that in the Exchange Act itself, Congress -- that is your context -- Congress used the words device and contrivance virtually interchangeably with the words acts and practices.

If you look, for example, at section 15(c)(1) and 15(c)(2) of the Exchange Act, and more importantly you read the legislative history that accompanies those two sections, and why the Congress wrote section 15(c)(1) and 15(c)(2) the way that they did, I think it is illustrative of the point that those concepts were roughly interchangeable.

Also, if you look at the legislative history of section 10(b), again if my recollection is correct, the Senate report, reporting out the bill that ultimately became the Exchange Act as modified by the House bill, I think you will find that the Senate report refers to section 10(b) as proscribing the use of manipulative or deceptive acts and practices.

So I don't think, Mr. Justice Rehnquist, that you can look at the words standing along or in isolation or outside of the context within which they were passed and

say that in an equitable proceeding Congress absolutely intended that the commission demonstrate scienter, particularly when in a footnote that runs on for two pages in our brief -- particularly when in that footnote the Congress otherwise used a whole array of culpability words. It certainly knew how to use them when it wanted to -- a whole array of culpability words, and didn't here.

QUESTION: Mr. Ferrara, I don't recall that either you or your friend have touched the subject of whether the Court of Appeals in its review and in its opinion went beyond what it needed to go with respect to the findings here.

MR. FERRARA: Well --

QUESTION: What were the findings specifically of the District Court with reference to this statute?

MR. FERRARA: The District Court found that the defendant knew of the misconduct of the people that were under his supervision and also had reason to know that they were making false statements because as part of his managerial responsibilities at the firm, that he maintained the due diligence files. Due diligence files are files containing current and accurate financial information that are required to be maintained by market makers, those who affirmatively sell stock for their own account. Well, the court --

QUESTION: That being so --

MR. FERRARA: Let me respond to your question.

QUESTION: All right.

MR. FERRARA: The District Court found that he had acted knowingly and with reason to know and accordingly had met the scienter standards of Hochfelder and then went on to find that under either a negligence or a scienter theory of liability, the defendant was liable. That went to the Court of Appeals.

QUESTION: The District Court?

MR. FERRARA: The District Court found that under either a negligence or scienter theory of liability, the defendant should be enjoined. That question goes up to the Court of Appeals. The Court of Appeals only went so far to reach that portion of the District Court's conclusions of law that said negligence could suffice, and the Court of Appeals in a unanimous panel said we think negligence is the appropriate standard, that is as far as we have to do, and that is as far as the court went.

The only time the Court of Appeals spoke to the question of the defendant's scienter was in part five of the Court of Appeals opinion, where the court noted that the District Court judge had properly taken the scienter of the defendant into account in determining whether to issue an injunction. So the Court of Appeals only addressed the

scienter question in that limited context, that is whether the District Court properly issued an injunction and not in the context of establishing liability.

QUESTION: Would it be fair to say that was an alternative holding in the District Court?

MR. FERRARA: The District Court judge did not express it that way. The District Court judge said that either under a negligence or a scienter theory he was liable. I'm not --

QUESTION: Doesn't that ring like an alternative holding?

MR. FERRARA: Yes, I think it does. In just looking at the words, either one or the other --

QUESTION: It could have affirmed on the basis of the lesser standard, could it not?

MR. FERRARA: It could have, the Court of Appeals could have said I suppose that -- well, one of the issues before the Court of Appeals was whether or not the defendant's conduct amounted to scienter, as the District Court judge had found, or alternatively whether the District Court judge was clearly erroneous in that regard. The Court of Appeals could have said we are going to review the District Court's determinations, we're going to find that the defendant acted with scienter, therefore it is unnecessary for us to resolve the question of whether negligence or the appropriate

standard. The Court of Appeals did not do that. The Court of Appeals only went to the negligence question, which was perfectly appropriate for it to do, given the two bases of the District Court's conclusion.

QUESTION: I take it then you do not regard that part of the holding as dictum?

MR. FERRARA: The Court of Appeals.

QUESTION: Yes.

MR. FERRARA: Oh, no, not at all. That is the essential holding of the case.

QUESTION: Even though they could have acted and decided the case on a narrower ground?

MR. FERRARA: I'm not sure that because a court could have decided the case on a different ground it necessarily means the ground that it decided it on was dicta. That is the holding of the case. As I say, had the court --

QUESTION: It is clear that the court describes that as its holding, and I was trying to go behind the language of the court and see whether --

MR. FERRARA: Well, I think had the Second Circuit said that we affirm the District Court's findings of scienter and then said but we're going off on a negligence standard of liability, then I think perhaps the standard the court chose may have been dicta. The Court of Appeals did not do that. The Court of Appeals

specifically said we are only reaching the negligence question.

In concluding, I would like to spend just a moment if I may in saying why or explaining why the commission took really the unusual step of asking this Court to grant certiorari in this case, even though the District Court found in its favor on all of the counts charged in its complaint and entered a final judgment of permanent injunction and even though the Second Circuit Court of Appeals in a unanimous decision affirmed the District Court, and even though the commission believes that both lower courts were correct in their holding and in their conclusion that scienter was not required in the commission injunctive action.

In doing that, I think it is important to understand what the commission is contending in this court and perhaps more importantly what it is not contending in the court. As this Court knows, in the past several years the commission has participated before this Court in several cases where private parties have raised important issues under the federal securities laws and have raised questions regarding the scope and effectiveness of those laws, and oftentimes the commission and I appearing on behalf of the commission or the Solicitor General appearing on behalf of the commission have appeared before the Court to express

the view that private damage actions play an essential role in the enforcement of the federal securities laws, that they serve as an essential supplement to the commission's own enforcement actions.

Well, the Court's message has been I think that however laudable the purpose of private actions, the proper scope of those private actions is to enforce the federal securities laws are quite limited. The Court's restrictions I think of the substantive provisions that can serve as a basis for private enforcement of the federal securities laws, as in the Lewis v. Transamerica case, the Court's definitions of the requirements for private actions to enforce the federal securities laws, as under the Blue Chip Stamps and Hochfelder case, have had a number of significant effects on how the laws are enforced, and I think perhaps the most significant effect that it has had is the fact that it has shifted the balance of the manner in which these laws have to be enforced.

The government, which has always had the primary role for enforcing the federal securities laws has to take on now an even greater burden, and that is why we are here. That is why we asked that this Court take this action. Scienter simply cannot be a prerequisite for a commission injunctive action.

MR. CHIEF JUSTICE BURGER: Your time is expired.

QUESTION: Mr. Ferrara, you have been addressing generalities, may I ask you a general question.

MR. FERRARA: Yes, sir.

QUESTION: The commission has had a long experience with injunctions under 20(b). As a practical matter, what is the effect of a permanent injunction against a brokerage firm or whoever issued by the SEC?

MR. FERRARA: Well, I think that the injunction has three very critical things -- well, let me respond in two ways. One, the injunctive provision is the commission's principal enforcement tool, the only tool that we really have against the great masses. We don't assess fines. We don't assess penalties. We only seek injunctions, with the exception of the regulated community. So it is our primary enforcement tool, and the commission is primarily a law enforcement agency. We are unlike the FCC and the host of other independent regulatory agencies. We are not primarily a regulator or a licensor. We are a law enforcement agency, and this is our principal tool.

Now, what does the injunction do? Well, we think that it brings the defendant's attention in a very focused way to his past infractions, it lays down in an admonition for the defendant as to what is expected of him in the future, and it gives -- it stimulates I think future compliance with the federal securities laws through a judicial

mandate. It is those three objectives that we seek in seek-injunctive actions, and that is really again all we have.

QUESTION: What does it do to the defendant?

MR. FERRARA: Well, there are some collateral consequences that attach to the issuance of an injunction. Certainly, those who have been found to have carelessly engaged in misconduct which results in a deception of investors and a federal District Court judge has found it reasonably likely to recur and they are therefore enjoined are going to suffer some inconveniences.

On the other hand, the statutory collateral consequences that can attach to the entry of an injunctive decree are largely discretionary. In other words, any defendant in an injunctive action that has a collateral consequence attach, a regulatory disability, for example, of not being able to serve as an investment adviser to an investment company, a regulatory disability that relates to whether or not that issuer, if it is an issuer of securities, can use the Regulation A exemption. All of those collateral consequences are discretionary. The defendant in an injunctive proceeding can seek to have the regulatory collateral consequences not apply. The commission has to take into account all of the factors that are raised by the respondent in that collateral proceeding, he has full review in the courts of appeals, the courts of appeals have been very

rigorous with the commission, saying that they cannot act arbitrarily or capriciously in having the collateral consequences attach -- I mean, there is a host of protections.

QUESTION: I understand all of that. What I was interested in is if you were the broker and you had an injunction, a permanent injunction against you, what effect would it have on your business and daily operations, and would it last forever?

MR. FERRARA: Well, there are two specific regulatory disabilities that could be imposed that I recall.

QUESTION: What was imposed in this case?

MR. FERRARA: I'm sorry?

QUESTION: Go ahead and then tell me what was imposed in this case.

MR. FERRARA: The two specific regulatory disabilities I believe is that under section 9(a) of the Investment Company Act, the enjoined broker-dealer, if it had an investment adviser subsidiary, would be precluded from serving as an investment adviser to a registered investment company. That had no application in this case because Aaron & Company as far as I know did not have an investment adviser subsidiary. When that does happen, section 9(c) of the Investment Company Act allows the defendant to come in to the commission and seek to have that regulatory disability waived. Usually what happens when a broker-dealer

or investment adviser is involved in an injunctive action, is that the regulatory disability and the injunctive proceeding are resolved all at the same time.

The second disability that comes into play is that the broker-dealer may not be able to participate in offerings of securities under Regulation A. That is an exemption from the full registration provisions of the federal securities laws, but again that regulatory disability can be waived pursuant to the provisions of Regulation A itself.

Now, can the injunction ever be lifted? The courts have procedures for lifting the injunctions. I believe this Court in the Swift case laid down what the standards are and that at any time, conceivably from the day after the injunction has been entered to any time in the future, the defendant in an injunctive proceeding can go back before a federal District Court and ask to have the injunctive decree resolved because of reasons articulated by the Court in the Swift case.

Thank you.

MR. CHIEF JUSTICE BURGER: Mr. Fallick, do you have anything further:

ORAL ARGUMENT OF HARRY M. FALLICK, ESQ.,

ON BEHALF OF THE PETITIONER -- REBUTTAL

MR. FALLICK: Yes. Thank you, Mr. Chief Justice.

MR. CHIEF JUSTICE BURGER: You have undertaken to

reserve more than two-thirds of your time for rebuttal and I assume you will confine yourself to rebuttal material.

MR. FALLICK: Yes, sir.

Mr. Justice Powell, in answer to your question concerning the real implication of a permanent injunction, it would be a loss of business, loss of reputation, and the practical effect would be the person would be out of business, especially for a small broker as was E. L. Aaron & Comapny. The loss of reputation was devastating. They went out of business and Mr. Aaron, of course, is no longer in the securities business.

QUESTION: I suppose that in a commission injunction action, the only thing the commission can show about past conduct is that it was negligent. I suppose the defendant could at least make an argument that, well, maybe I did it but it was careless only, it was only negligent, it wasn't intentional and therefore you shouldn't issue an injunction. You should at least wait until I do it again knowingly.

MR. FALLICK: Once a defendant has been put on notice that his past conduct is negligent and he persists in that conduct, of course, then he is making a conscious effort to --

QUESTION: To violate the law.

MR. FALLICK: -- to violate the law.

QUESTION: I suppose that you could conceive of the government being able to show that, well, he did it negligently in the past and carelessly, and he is liable to do it again, even though he has now been told that it was deceptive, and he is so likely to deliberately violate the law in the future, that an injunction could issue?

MR. FALLICK: If a defendant --

QUESTION: And you wouldn't object to that if they could make such a showing as that?

MR. FALLICK: Not at all. One of the factors in issuing injunctions --

QUESTION: He might have been told that that is a theory of the SEC, but he might wholly disagree with it, and my brother White's theory puts him in a position where he can't voice his disagreement except at the risk of an injunction against him.

QUESTION: It would have to be found that this was deceptive.

MR. FALLICK: Yes, that is correct. The past conduct is negligent, but of course if he continues and persists and says he doesn't believe that it was negligent and he is going to continue doing it and there is a motive to continue and it is going to be some type of personal gain, then of course his future conduct would create a standard --

QUESTION: It would be knowing.

MR. FALLICK: It certainly would be.

Thank you, Mr. Chief Justice.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 2:36 o'clock p.m., the case in the above-entitled matter was submitted.)

- - -