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SECURITIES

OVERVIEW

During the period covered by this survey,[1] the Tenth Circuit decided only three cases dealing with the Securities Act of 1933 (1933 Act)[2] or the Securities Exchange Act of 1934 (1934 Act).[3] All three cases involved allegations of violations of section 10(b) of the 1934 Act[4] and rule 10b-5.[5] Also considered in these three cases were sections 17(a) of the 1933 Act[6] and 7(c)(1) of the 1934 Act,[7] regulation T,[8] rule 17a-3,[9] and the federal Administrative Procedures Act.[10]

Although no startling concepts were introduced by the Tenth Circuit in these cases, they may be of interest as illustrations of this Circuit's application of principles previously discussed and accepted by this or other circuits.

I. WHERE CLAIMS ARE MADE UNDER THE 1933 ACT AND 1934 ACT BY A BROKER'S CUSTOMERS, AGREEMENTS TO ARBITRATE ARE NOT ENFORCEABLE

In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*,[11] Mr. and Mrs. Moore originally had alleged in state court negligence, breach of fiduciary duty, and violation of rules of the National Association of Securities Dealers (NASD) and the New York Stock Exchange by Merrill Lynch.[12] After Merrill Lynch removed the case to United States District Court as a diversity action, the Moores alleged violation of section 17(a) of the 1933 Act,[13] section 10(b) of the 1934 Act,[14] and rule 10b-5.[15] The Moores had signed agreements which contained clauses agreeing to arbitrate; Merrill Lynch won an order to arbitrate before the NASD in the district court and the Moores appealed.[16] The court discussed at length the decision in and policy behind *Wilko v. Swan*,[17] the leading case to deny enforcement of agreements

1. This survey covers cases in which opinions were filed from September 1, 1978 to May 31, 1979.
2. 15 U.S.C. §§ 77a-77aa (1976).
3. 15 U.S.C. §§ 78a-78ii (1976).
4. 15 U.S.C. § 78j(b) (1976).
5. 17 C.F.R. § 240.10b-5 (1978).
6. 15 U.S.C. § 17q(a) (1976).
7. 15 U.S.C. § 78q(c)(1) (1976).
8. 12 C.F.R. §§ 220.1-.8 (1978).
9. 17 C.F.R. § 240.17a-3 (1978).
10. 5 U.S.C. §§ 551-559 (1976).
11. 590 F.2d 823 (10th Cir. 1978).
12. *Id.* at 824.
13. 15 U.S.C. § 77q(a) (1976). This action only concerned the agreement to arbitrate; therefore, Judge Doyle in this opinion did not address his position that there are no implied civil remedies under § 17(a). Trussell v. United Underwriters, Ltd., 228 F. Supp. 757 (D. Colo. 1964).
14. 15 U.S.C. § 78j(b) (1976).
15. 17 C.F.R. § 240.10b-5 (1978).
16. 590 F.2d at 825; *see* note 28 *infra*.
17. 346 U.S. 427 (1953).

to arbitrate under the federal securities laws. In *Wilko*, the Court had relied upon the provisions in section 14 of the 1933 Act.[18] The Tenth Circuit, relying on *Wilko*, also applied section 14 to void the arbitration agreements and to obtain remedies under the 1933 Act in *Moore*. The 1933 Act disposition was limited to section 12(2) remedies, *i.e.*, those which had been litigated in *Wilko*.[19]

The other questions, which had not been decided previously in this circuit and which were not as obvious as the application of the *Wilko* rule to claims under the 1933 Act, were whether the rule in *Wilko* applied to an action brought under section 10(b) of the 1934 Act and whether actions brought under rule 10b-5 were subject to the *Wilko* rationale.

The court commented that the policy considerations did not differ for remedies under either Act and that section 29(a) of the 1934 Act[20] is nearly identical to section 14 of the 1933 Act.[21] It also explained that since section 29(a) expressly included rules and regulations within its ambit,[22] the *Wilko* holding would also apply to actions brought under section 10b-5.

Finally, the Tenth Circuit rejected the contention that *Scherk v. Alberto-Culver Co.*[23] was applicable.[24] Following the lead of other circuits,[25] the court limited the holding of *Scherk*, which enforced agreements to arbitrate under the 1934 Act, to only those situations where international agreements are involved. The court concluded its opinion by emphasizing the importance of rule 10b-5[26] and its belief that placing it in an "inferior position" is nonsensical.[27]

The agreements signed by the Moores limited their choices of arbitration panels to those composed of stockbrokers.[28] Although the concern was

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18. 15 U.S.C. § 77n reads in full as follows: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

19. 590 F.2d at 827; *see* note 13 *supra*.

20. 15 U.S.C. § 78cc(a) reads as follows: "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

21. *See* notes 18 and 20 *supra*.

22. *See* note 20 *supra*.

23. 417 U.S. 506 (1974).

24. 590 F.2d at 829.

25. Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831 (7th Cir. 1977); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976); Laupheimer v. McDonnell & Co., 500 F.2d 21 (2d Cir. 1974).

26. "Rule 10b-5 is, after all, the most important remedy in both Acts." 590 F.2d at 829. While it cannot be disputed that actions under rule 10b-5 may be the most numerous types of actions brought under the securities laws, other provisions of the 1933 Act may be of greater importance for plaintiffs for whom those actions are available. *See, e.g.*, *Section 17(a) of the 1933 Securities Act: An Alternative to the Recently Restricted Rule 10b-5*, 9 RUT.-CAM. L.J. 340 (1977), for a discussion of the advantages of actions under section 17(a) of the 1933 Act over those under rule 10b-5, including the possibility of punitive damages and the availability of state courts as a forum.

27. 590 F.2d at 829.

28. One agreement which the Moores signed contained the following clause:

> Any controversy between us arising out of such option transactions or this agreement shall be settled by arbitration before the National Association of Securities Dealers, Incorporated, or the New York Stock Exchange, or the American Stock Exchange, only. I shall have the right of election as to which of the foregoing tribunals shall

not articulated by the court in this opinion, the reluctance to force the resolution of claims by investors against brokerage firms before a panel of stockbrokers by this and other courts is understandable, especially where the investor is unsophisticated.[29]

II. EXAMPLES OF WHAT ARE NOT NONDISCLOSURE, MANIPULATION, AND MISREPRESENTATION UNDER 10(B) AND 10B-5

In *Kin-Ark Corp. v. Boyles*,[30] a counterclaim was brought[31] alleging violation of section 10(b)[32] and rule 10b-5[33] in a stock-for-assets transaction.[34]

A. *Failure to Disclose*

The first matter discussed in this case was an alleged illegal failure to disclose that officers and directors of Kin-Ark had interests in investments

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conduct the arbitration. Such election is to be by registered mail, addressed to Merrill Lynch's head office . . . . postmarked within five days after the date of demand to make such election. At the expiration of the five days I hereby authorize Merrill Lynch to make such election on my behalf.

590 F.2d at 825 n.2. The Moores also signed an agreement with the following clause:

It is agreed that any controversy between us arising out of your business or this agreement, shall be submitted to arbitration conducted under the provisions of the Constitution and Rules of the Board of Govenors of the New York Stock Exchange, except however if the controversy involves any security or commodity or transaction or contract relating thereto executed on an exchange located outside of the United States then such controversy, at the election of either of us, shall be submitted to arbitration conducted under the Constitution and rules of such exchange (and if neither of us so elects, arbitration shall be conducted under the provisions of the Constitution and Rules of the Board of Governors of the New York Stock Exchange). Arbitration must be commenced within one year after the cause of action accrued by service upon the other of a written notice of intention to arbitrate, naming therein the arbitration tribunal.

Id.

29. The district court had found the Moores to be unsophisticated "businessmen" and the circuit court accepted this finding. 590 F.2d at 825 n.1.

Agreements to arbitrate may be enforced where there are agreements between: (1) members of stock exchanges, Coenen v. R.W. Presspich & Co., 453 F.2d 1209 (2d Cir. 1972); *In re* Revenue Properties Litigation Cases, 451 F.2d 310 (1st Cir. 1971); or (2) a stock exchange member and its former employee, Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 353 F. Supp. 1084 (D. Pa. 1973); *but see* Laupheimer v. McDonnell & Co., 500 F.2d 21 (2d Cir. 1974). Also, there may be exceptions where an agreement to arbitrate is made after the claim has matured, as opposed to agreements made to arbitrate unknown controversies which may arise in the future, because the investor has the opportunity to investigate any disadvantages to litigating the particular claim under arbitration when compared to a judicial forum; *compare* Fox v. Kane-Miller Corp., 398 F. Supp. 609 (D. Md. 1975) *with* Korn v. Franchard Corp., 388 F. Supp. 1326 (S.D.N.Y. 1975); or where there is an intelligently negotiated agreement, Murtagh v. University Computing Co., 490 F.2d 810 (5th Cir. 1974); Mittendorf v. J.R. Williston & Beane, Inc., 372 F. Supp. 821 (S.D.N.Y. 1974).

The standard agreements attempting to require investors to arbitrate before brokers have been criticized other than in the courts. *See Arbitrations of Investor-Broker Disputes*, 66 CALIF. L. REV. 120 (1977).

30. 593 F.2d 361 (10th Cir. 1979).

31. Kin-Ark had sued for unpaid interest on a debt owed to Kin-Ark. One defendant asserted that the note was usurious under Texas law; the circuit court agreed and imposed a statutory penalty against Kin-Ark. 593 F.2d at 365.

32. 15 U.S.C. § 78j(b) (1976).

33. 17 C.F.R. § 240.10b-5 (1978).

34. Kin-Ark purchased Boyles Galvanizing, Inc. All appellants were stockholders of the company purchased by Kin-Ark which was then made a wholly owned subsidiary of Kin-Ark. 593 F.2d at 363-65.

made by Kin-Ark[35] in a prospectus prepared for a public rights offering of Kin-Ark stock shortly before Kin-Ark's purchase of the Boyles company. The losing argument was that knowledge of management's interest in these investments would have shaken confidence in "management's devotion to the interests of its shareholders."[36] The court stressed the de minimis nature of these investments to Kin-Ark in holding that there was no material omission[37] and therefore no violation. One investment constituted 0.72 percent and the other 0.42 percent of Kin-Ark's total investments.[38] The valuations appear not to have been computed for dates even close to one another in time,[39] and any test of the limits of materiality, at least in terms of a portion of investments, is not determinable from this case because the total percentage of investments involved at the time the prospectus was issued, or at any single time, is unknown. Indeed, the implication arises in this circuit by reason of this case that the significance of an omission may be settled by using the value of investments at the time they are purchased rather than at the time a prospectus is issued for a public offering.

B. *Manipulation of a Public Offering*

The next claim alleged manipulation of a public offering. Some holders of long term debt in Kin-Ark accepted early payment and purchased Kin-Ark stock at Kin-Ark's urging; Kin-Ark also redeemed convertible debentures at a discount price and holders of the debentures purchased the same amount of stock they would have been able to purchase if the debentures

35. Kin-Ark purchased 10% of Antipodes Exploration, Inc. (Antipodes), and two members of Kin-Ark's management owned a total of 13.5% of Antipodes. Kin-Ark also acquired a 50% interest in oil and gas leases in a joint venture with T.L.M., Inc. (T.L.M.), of which Kin-Ark's directors owned 12.5%. *Id.* at 366.

36. *Id.*

37. *See* Jacobs, *What is a Misleading Statement or Omission Under Rule 10b-5?*, 42 FORDHAM L. REV. 243 (1973). It is possible that this could be considered material. One of the tests of materiality which has been used is whether a reasonable person would attach importance to the nondisclosed item. TSC Indus. v. Northway, Inc., 426 U.S. 438 (1976). The court in SEC v. Texas Gulf Sulfur Co., 258 F. Supp. 262 (S.D.N.Y. 1966) would not accept a test of materiality which was based solely on its relationship to earnings (but the court did state that the test must be conservative in order to limit meritless litigation). That a potential investor would attach importance to the shared investments of the corporation and its management, even though they are presently a small part of the corporation's investment, could be construed as reasonable; though it may not directly relate to present earnings it could give the investor a persuasive criterion for evaluating possible future handling of the corporation's affairs. *See generally* Stevenson, *The New Disclosure*, 62 CORNELL L. REV. 50, 72-82 (1976), for a discussion of the effectiveness of disclosure on management's conduct and reasons for requiring disclosure in the context of proposed rules and noneconomic standards of materiality. *See also* Kripke, *Rule 10b-5 Liability and "Material" "Facts"*, 46 N.Y.U. L. REV. 1061 (1971), for a criticism of common tests of materiality which have been used, especially when phrased in terms of percentages.

38. The Antipodes investment was 0.72% of Kin-Ark's investment when it was made, and that acquisition date is not specified by Judge Breitenstein in this opinion, while the T.L.M. investment accounted for 0.42% of Kin-Ark's total investments in July 1969, the month the public offering had commenced. At the time of the Antipodes investment, Kin-Ark's total investments were $5,564,845 while in July 1969 they totalled $10,653,773. 593 F.2d at 366.

The court did not discuss whether the Antipodes investment had appreciated or depreciated by the date of the 1969 public offering nor did it offer any clue as to what percentage of Kin-Ark's total investments the Antipodes investment later constituted.

39. In July 1969 Kin-Ark's total investments were almost double what they had been when the Antipodes interest was purchased. *See* note 38 *supra*.

had been converted at maturity at their normal rate.[40] The court relied upon two grounds for its holding that no rule 10b-5 violations occurred: (1) the closing agreement signed by all parties recited the fact that the closing was contingent upon sale of a required number of shares of stock and thus there were no grounds for complaint when a sale of stock was made; and (2) Kin-Ark had exercised "sound business judgment" in paying its debts and selling the required minimum number of shares of stock.[41] The court also distinguished these facts from a situation where there is a material alteration of distribution methods.[42]

C. *Misrepresentation*

Finally, the court dismissed an allegation of misrepresentation of financial condition. Kin-Ark had not included in its prospectus a two-year-old unfavorable real estate analysis of two investments; it did include a "bleak and discouraging account," the large operating losses, and an accountant's report which was qualified by reason of these investments. The court emphasized the lack of alteration of the total mix of information which the real estate analysis would have added.[43]

III. SANCTIONS AGAINST BROKER-DEALERS

In *Mawod v. SEC*,[44] Mawod, individually, and his firm, Edward J. Mawod and Company, unsuccessfully sought to overturn the order of the Securities and Exchange Commission (SEC) which had revoked the firm's registration as a broker-dealer and suspended Mawod from association with any broker-dealer for one year.[45]

The action originated over trading in a real estate corporation which was substantially underfunded and the stock of which was publicly traded after a Regulation A exemption had been filed.[46] Of 187,000 shares sold during the initial offering, a total of 159,000 were sold to a friend of the corporation's financial advisor, the president of the underwriter, and another principal and trader. Although trading was inactive after the initial offering, a merger was arranged, to be pursued by one Strand. Mawod previously had prevented Strand from trading at his firm, but he permitted Strand to use the firm's premises and facilities to trade this stock in a nominee account, although he asked someone to watch Strand. Another individual, O'Quinn, worked with Strand.[47] O'Quinn and Strand created a market for the stock through wash sales, matched orders,[48] and sales above the bid

40. 593 F.2d at 366-67.

41. *Id.* at 367. *See* Financial Indus. Fund, Inc. v. McDonnell Douglas Corp., 474 F.2d 514 (10th Cir. 1973), for another example of deference to the business judgment where claims were made under the federal securities laws.

42. 593 F.2d at 367.

43. *Id.*; *see* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976); Hassig v. Pearson, 565 F.2d 644 (10th Cir. 1977).

44. 591 F.2d 588 (1979).

45. *Id.* at 590.

46. *Id.*

47. *Id.* at 590-91.

48. The SEC defined wash sale as "one in which the ownership of the security remains

and ask price. Later, fearing an inability to pay on the part of O'Quinn and Strand, Mawod terminated the account and the prices for the stock then fell.[49]

The SEC determined that the corporation was a shell which ordinarily would not have had a market and that the matched trades and wash sales were manipulative. Mawod and his firm were found by the court to have aided and abetted the manipulation, which violated section 17(a) of the 1933 Act,[50] section 10(b) of the 1934 Act,[51] and rule 10b-5.[52] The court also agreed that section 7(c)(1) of the 1934 Act,[53] regulation T,[54] and rule 17a-3[55] had been violated.

A. *Regulation T*[56] *and Rule 17a-3*

Mawod argued that the O'Quinn account was a C.O.D. account[57] which permits thirty-five days instead of seven days for payments under regulation T, but the court noted that Mawod and Company's policy for years had been to make clear to their customers that C.O.D. accounts were not available to any customers.[58] In its finding of a regulation T violation, the court observed also that there was no evidence that Mawod was authorized to use credit balances in the O'Quinn-Strand account to cover stock purchases.[59]

The circuit court agreed with the SEC that Mawod and Company vio-

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unchanged" and a matched order as "one placed with the knowledge that an offsetting order had already been or is about to be placed." These are prohibited by section 9(a)(1) of the 1934 Act. 12 SEC DOCKET 363, 366 (1977). *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 205 n.25 (1976), for a similar definition by the Supreme Court.

49. 591 F.2d at 591.

50. 15 U.S.C. § 77(q)(a) (1976).

51. 15 U.S.C. § 78j(b) (1976).

52. 17 C.F.R. § 240.10b-5 (1978).

53. 15 U.S.C. § 78g(c)(1) (1976).

54. 12 C.F.R. §§ 220.1-.8 (1978).

55. 17 C.F.R. § 240.17a-3 (1978).

56. Regulation T is one of the regulations promulgated by the Board of Governors of the Federal Reserve System under section 7 of the 1934 Act, 15 U.S.C. § 78g (1976), controlling margin requirements for credit on securities. It is enforced by the SEC and applies to every broker-dealer. N. WOLFSON, R. PHILLIPS, & T. RUSSO, REGULATION OF BROKERS, DEALERS AND SECURITIES MARKETS ¶¶ 9.01-.03 (1977).

57. These are governed by 4(c)(5) of regulation T, 12 C.F.R. § 220.4(c)(5) (1978). For a description of the types of accounts included under the control of regulation T, *see Credit Regulation in the Securities Market: An Analysis of Regulation T*, 62 NW. L. REV. 587 (1967).

58. 591 F.2d at 594. The court did not address the SEC finding that regulation T requires prompt payment upon delivery within the 35 day maximum and is only applicable where the mechanics of trade, and not the customer's willingness to pay, prevent earlier delivery. 12 SEC DOCKET 363 (1977). In the past the SEC has only permitted transactions in a C.O.D. account where the broker could show that mechanics of trade prevented earlier delivery by the broker. *In re* John W. Yeaman, Inc., 42 SEC 500 (1965); *In re* Madison Management Corp., 42 SEC 390 (1964); *In re* Palombi Sec. Co., 41 SEC 266 (1962); *In re* Coburn & Middlebrook, Inc., 37 SEC 583 (1957).

The court dismissed arguments over the existence of credit balances in the account at various times with the statement that whether a credit balance existed or not was irrelevant since there was no authorization to use it. 591 F.2d at 593-94.

59. One court has found no duty for a broker-dealer to obtain a written margin agreement where the customer understands the elements of that type of transaction. Bell v. J.D. Wine & Co., 392 F. Supp. 646 (S.D.N.Y. 1975).

lated rule 17a-3(a)(9) under section 17(a) of the 1934 Act when it did not enter in its records Strand's interest in O'Quinn's account. The court said that control over an account is not the test. It noted, however, as persuasive to show a violation had occurred the fact that Strand had admitted exercising some control over the account, along with the fact that checks were made out by Mawod to Strand for the O'Quinn account, and that Mawod was otherwise aware of the Strand-O'Quinn relationship.

B. *Manipulations*

Mawod and his firm did not dispute that manipulation of the market had occurred; they pleaded lack of knowledge of the cause.[60] The court recited some of the facts and said it found sufficient evidence[61] to support the charge of aiding and abetting the manipulation.[62] (Matched orders and wash sales are per se manipulation.)[63] The court also indicated its respect for SEC "insight" and its reluctance to disturb SEC findings. Respect for the SEC, which may have been a most persuasive factor,[64] permitted omission of a lengthy analysis of the facts in this portion of the court's discussion.

C. *Scienter*

The court next dealt with the applicability of scienter.[65] The Supreme Court in *Ernst & Ernst v. Hochfelder*[66] specifically left open the questions of whether scienter[67] applied to SEC actions for injunctions and whether recklessness[68] sufficed as scienter under securities laws provisions.[69] The

60. 591 F.2d at 595. *See Rule 10b-5 Liability After* Hochfelder: *Abandoning the Concept of Aiding and Abetting*, 45 U. CHI. L. REV. 218, 231-42 (1977) for a discussion of the knowledge necessary for a violation.

61. The standard for support of an agency decision is substantial evidence under the Administrative Procedure Act, 15 U.S.C. § 77i of the 1933 Act and 15 U.S.C. § 78y of the 1934 Act, according to the Tenth Circuit, 591 F.2d at 593, although 15 U.S.C. § 77i does not use the term "substantial."

62. The court does not address the SEC's discussion that deception is a violation as manipulation even if no one in the market is damaged. 12 SEC DOCKET at 367-68. Creating the false impression of market activity is manipulative. Hundahl v. United Benefit Life Ins. Co., 465 F. Supp. 1349 (D. Tex. 1979). The Tenth Circuit did not set out the elements of aiding and abetting but stated that knowledge and substantial assistance are necessary. In SEC v. National Student Marketing Corp., 457 F. Supp. 682 (D.D.C. 1978), the court set out these tests: (1) another person has committed a securities violation; (2) the alleged aider and abettor has a general awareness that his role is improper; and (3) substantial assistance of the violation. *See also* 45 U. CHI. L. REV. at 225-42, *supra* note 60.

63. 591 F.2d at 595.

64. Other courts have indicated their respect for SEC opinions: SEC v. Parklane Hosiery, 558 F.2d 1083 (2d Cir. 1977) (SEC receives benefit of all reasonable doubt); Rolf v. Blyth Eastman Dillon & Co., 424 F. Supp. 1021 (S.D.N.Y. 1977) (SEC receives deference and its judgment receives great weight).

65. 591 F.2d at 595-97.

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

67. The Supreme Court defined scienter as a mental state embracing intent to deceive, manipulate, or defraud. *Id.* at 194 n.12.

68. The Supreme Court referred to recklessness only as a "form of intentional conduct." *Id.* Recklessness has been defined as "carelessness approaching indifference" and "closer to being a lesser form of intent than merely a greater degree of ordinary negligence." Hoffman v. Estabrook & Co., 587 F.2d 509, 516 (1st Cir. 1978).

69. 425 U.S. at 194 n.12.

Supreme Court also specifically reserved any judgment on the elements of aiding and abetting in *Hochfelder*.[70] The unresolved questions of *Hochfelder* have resulted in a great deal of commentary[71] and the court in *Mawod* discussed *Hochfelder*,[72] but it did not discuss clearly why it felt *Hochfelder* applied. *Mawod* involved administrative sanctions by the SEC over broker-dealers and associates of broker-dealers[73] and aiding and abetting violations.[74] The references by the court to injunctive actions and to *Hochfelder*'s applicability are confusing[75] because *Hochfelder* is clearly limited to private causes of action for damages,[76] and does not apply directly to SEC administrative enforcement actions.

The court noted that *Hochfelder* did "not express a view as to a public action such as this one"[77] but said that since the SEC had assumed that *Hochfelder* applied,[78] the court would also so assume.[79] An additional factor which was not discussed in *Mawod* was that the *statutory* standard in a disciplinary action by the SEC is "willful"[80] which itself has had court interpre-

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70. *Id.* at 191-92 n.7.

71. *E.g.*, Bucklo, *The Supreme Court Attempts to Define Scienter Under Rule 10b-5*: Ernst & Ernst v. Hochfelder, 29 STAN. L. REV. 213 (1977) (predicting the inclusion of recklessness within scienter); Lowenfels, *Scienter or Negligence Required for SEC Injunctions under Section 10(b) and Rule 10b-5: A Fascinating Paradox*, 33 BUS. LAW. 789 (1978) (noting that although courts state different standards, injunctions are not being issued without a finding of scienter); *The Scienter Requirements in SEC Injunctive Enforcement of Section 10(b) after* Ernst & Ernst v. Hochfelder, 77 COLUM. L. REV. 419 (1977) (arguing in favor of a negligence standard in injunctive proceedings); *New Light on an Old Debate: Negligence v. Scienter in an SEC Fraud Injunctive Suit*, 51 ST. JOHN'S L. REV. 759 (1977) (arguing against a negligence standard in injunctive proceedings).

72. 591 F.2d at 595-97.

73. The SEC has these powers under § 15(b)(4), (6) and 15 U.S.C. § 78o(b)(4), (6) (1976), where there are willful violations or willful aiding and abetting in the violation of any of the federal securities laws.

74. 591 F.2d at 590, 593.

75. Judge Doyle in the *Mawod* opinion stated that

> [t]he cases are not in full accord on applicability of *Hochfelder* to a case such as this. The prevailing rule would appear to be that willful or reckless behavior satisfies the scienter requirement. SEC v. Coven, 581 F.2d 1020 (2d Cir. 1978); Sanders v. John Nuveen & Co., 554 F.2d 790, 792 (7th Cir. 1977); SEC v. Coffey, 493 F.2d 1304, 1314 (6th Cir. 1974); Comment, *Scienter and SEC Injunctive Suits*, 90 HARV. L. REV. 1018, 1025 (1977).

591 F.2d at 596. The law review article cited *Coven, Coffey*, and SEC v. American Realty Trust, 586 F.2d 1001 (4th Cir. 1978); it in turn was cited by the Tenth Circuit but as authority that no scienter is necessary under § 17(a)(2) of the 1933 Act, 591 F.2d at 596. These cases all concern whether scienter is necessary in injunctive actions. *Sanders*, a class action, defined recklessness conservatively and said that it "can be sufficient to constitute scienter." The *Sanders* discussion may be considered dictum since the court found only negligence on the part of the defendant, not recklessness. None of the cases cited above by the court dealt with SEC disciplinary proceedings.

76. "We granted certiorari to resolve the question whether a private cause of action for damages will lie under § 10(b) and rule 10b-5 in the absence of any allegation of 'scienter' . . . ." 425 U.S. at 193. *See also* text accompanying note 68 *supra*.

77. 591 F.2d at 596.

78. The SEC said that Mawod acted with recklessness and referred to *Hochfelder* in a footnote with the signal "*Cf.*," SEC DOCKET at 371 n.50, which indicates that it "supports a proposition *different from* that in the text but sufficiently analogous to *lend* support." A UNIFORM SYSTEM OF CITATION 7 (Harv. L. Rev. Ass'n pub. 1976 (emphasis added)). Arguably the SEC did not assume that *Hochfelder* applied but only strengthened its argument by an analogy in what it considered an egregious case. *See* note 89 *infra*. Perhaps this is another example of the courts' deference to the SEC. *See* note 68 *supra*.

79. 591 F.2d at 596.

80. 15 U.S.C. § 78o (1976). *See* note 73 *supra*.

tations differing from the *Hochfelder* standard.[81]

Other courts have discussed these issues directly. In *Collins Security Corp. v. SEC*,[82] the court recognized that the reasoning of *Hochfelder*, but not its direct holding, may be applicable to SEC disciplinary proceedings against a broker-dealer.[83] Judge Friendly in *Arthur Lipper Corp. v. SEC*[84] discussed the difference between the "willful" standard as it had been applied by the SEC, *i.e.*, intentionally committing an act without proof of evil motive, and the *Hochfelder* standard, *i.e.*, proof of intention to deceive, manipulate, or defraud. He did not decide whether *Hochfelder* applied to disciplinary proceedings, although he noted the similarity between disciplinary proceedings and private actions because both apply to past conduct. He distinguished injunctive proceedings from SEC enforcement sanctions because injunctive proceedings deal with the threat of harmful future conduct,[85] although both injunctions and disciplinary actions are public actions.

The court in *Mawod* equated knowledge with willfulness and brought willfulness within the *Hochfelder* scienter requirement of the 1934 Act, without specifying that it was doing so, in order to bring enforcement proceedings by the SEC within the scope of *Hochfelder*. References in the opinion to cases and a comment dealing with injunctive proceedings,[86] without any references to or discussion of enforcement proceedings or the policies behind having the same or differing standards for cases brought for broker discipline rather than for damages or injunctions, make it difficult to determine whether the court intended one or both of the SEC injunctions and administrative enforcement actions to meet *Hochfelder* standards to be successful in the Tenth Circuit.

In addition, the guidance as to recklessness meeting the scienter requirement is vague. The court did not define recklessness but it did define willfulness, and then stated that willfulness exists where reckless indifference exists.[87] Since the defendants in this case were found to be willful and therefore liable under the 1934 Act, by backtracking through the reasoning of the court it appears that recklessness[88] will support a violation of the 1934 Act in this circuit in any type of action, *i.e.*, one for damages, one seeking an injunction, and one for disciplinary purposes.[89]

The court discussed the arguments against requiring scienter under section 17(a)(2) of the 1933 Act. It then simply stated it agreed with the SEC ruling that Mawod acted recklessly and that that was in accord with

81. N. WOLFSON, note 56 *supra*, at ¶ 2.01.
82. 562 F.2d 820 (D.C. Cir. 1977).
83. *Id.* at 826-27.
84. 547 F.2d 171 (2d Cir. 1977).
85. *Id.* at 180-81 n.6. *See also* 77 COLUM. L. REV. at 433, 439, *supra* note 71, for comments on differing treatments of scienter for injunctive and disciplinary actions.
86. *See* note 75 *supra*.
87. 591 F.2d at 596.
88. *See* note 68 *supra*.
89. *Cf.* text accompanying notes 84 and 85 *supra*. The SEC has taken the position that *Hochfelder* does not apply to its administrative proceedings. 9 ANN. INST. ON SEC REG. 730-34 (1977).

Hochfelder,[90] but it did not say why recklessness was in accord with *Hochfelder* under the 1933 Act when the *Hochfelder* Court had specifically refused to rule on whether scienter included recklessness.[91] We are left with the questions: Did the court refuse to adopt a scienter standard but still find that recklessness was sufficient for a violation? Or did the court, after discussing the arguments *against* requiring scienter and without giving any reasons for rejecting those arguments, decide that scienter is required and decide, again without giving its reasons, that recklessness is included within scienter?

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90. 591 F.2d at 596-97.
91. 425 U.S. at 194 n.12.