

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

**SECURITIES AND EXCHANGE COMMISSION v.
EDWARDS****CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR
THE ELEVENTH CIRCUIT**

No. 02–1196. Argued November 4, 2003—Decided January 13, 2004

Respondent was the chairman, chief executive officer, and sole shareholder of ETS Payphones, Inc., which sold payphones to the public via independent distributors. The payphones were offered with an agreement under which ETS leased back the payphone from the purchaser for a fixed monthly payment, thereby giving purchasers a fixed 14% annual return on their investment. Although ETS' marketing materials trumpeted the "incomparable pay phone" as "an exciting business opportunity," the payphones did not generate enough revenue for ETS to make the payments required by the leaseback agreements, so the company depended on funds from new investors to meet its obligations. After ETS filed for bankruptcy protection, the Securities and Exchange Commission (SEC) brought this civil enforcement action, alleging, among other things, that respondent and ETS had violated registration requirements and antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, and Rule 10b–5 thereunder. The District Court concluded that the sale-and-leaseback arrangement was an "investment contract" within the meaning of, and therefore subject to, the federal securities laws. The Eleventh Circuit reversed, holding that (1) this Court's opinions require an "investment contract" to offer either capital appreciation or a participation in an enterprise's earnings, and thus exclude schemes offering a fixed rate of return; and (2) those opinions' requirement that the return on the investment be derived solely from the efforts of others was not satisfied when the purchasers had a contractual entitlement to the return.

Held: An investment scheme promising a fixed rate of return can be an "investment contract" and thus a "security" subject to the federal se-

Syllabus

curities laws. Section 2(a)(1) of the 1933 Act and §3(a)(10) of the 1934 Act define “security” to include an “investment contract,” but do not define “investment contract.” This Court has established that the test for determining whether a particular scheme is an investment contract is “whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.” *SEC v. W. J. Howey Co.*, 328 U. S. 293, 301. This definition embodies a flexible, rather than a static, principle that is capable of adaptation to meet the countless and variable schemes devised by those seeking to use others’ money on the promise of profits. *Id.*, at 299. The profits this Court was speaking of in *Howey* are profits—in the sense of the income or return—that investors seek on their investment, not the profits of the scheme in which they invest, and may include, for example, dividends, other periodic payments, or the increased value of the investment. There is no reason to distinguish between promises of fixed returns and promises of variable returns for purposes of the test, so understood. In both cases, the investing public is attracted by representations of investment income. Moreover, investments pitched as low risk (such as those offering a “guaranteed” fixed return) are particularly attractive to individuals more vulnerable to investment fraud, including older and less sophisticated investors. Under the reading respondent advances, unscrupulous marketers of investments could evade the securities laws by picking a rate of return to promise. This Court will not read into the securities laws a limitation not compelled by the language that would so undermine the laws’ purposes. Respondent’s claim that including investment schemes promising a fixed return among investment contracts conflicts with precedent is mistaken, as no distinction between fixed and variable returns was drawn in the blue sky law cases that the *Howey* Court relied on, and no post-*Howey* decision is to the contrary, see *United Housing Foundation, Inc. v. Forman*, 421 U. S. 837, 852–853. Dictum suggesting otherwise in *Reves v. Ernst & Young*, 494 U. S. 56, 68, n. 4, was incorrect. The SEC has consistently maintained that a promise of a fixed return does not preclude a scheme from being an investment contract. The Eleventh Circuit’s alternative holding, that respondent’s scheme falls outside the definition because purchasers had a contractual entitlement to a return, is incorrect and inconsistent with this Court’s precedent. Pp. 3–8.

300 F. 3d 1281, reversed and remanded.

O’CONNOR, J., delivered the opinion for a unanimous Court.