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David B. Rand

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PUNITIVE DAMAGES IN IMPLIED CIVIL ACTIONS UNDER THE SECURITIES ACTS

I. INTRODUCTION

Both the Securities Act of 1933¹ and the Securities Exchange Act of 1934² contain comprehensive sections designed to regulate fraudulent practices in the issuance, sale, and exchange of securities.³ Neither of these sections, however, expressly provide civil remedies for an aggrieved plaintiff. Nevertheless, the courts have implied a civil cause of action arising from a violation of these statutory provisions.⁴

This Comment will consider the question whether exemplary damages may be recovered⁵ in an implied civil action under these statutes. In considering this question it shall be assumed that a valid cause of action, allowing compensatory damages, has been established. This Comment will compare the two securities acts in light of their express provisions, and the judicial interpretations which have been given to them. Emphasis will be placed on the recent decisions of *Globus v. Law Research Service, Inc.*⁶ and *de Haas v. Empire Petroleum Inc.*,⁷ cases which discussed the issue of punitive damages in implied civil actions under the acts. Consideration will also be given to the policy factors involved in the awarding of punitive damages, and whether these factors may be validly applied to the area of securities regulation.

Before any discussion is undertaken concerning the award of punitive damages under either the Securities Act of 1933 or the

1. 15 U.S.C. §§ 77a-aa (1964) [hereinafter referred to as the Securities Act and the 1933 Act].

2. 15 U.S.C. §§ 78a-hh (1964) [hereinafter referred to as the Exchange Act and the 1934 Act].

3. The Securities Act's antifraud provision is contained in § 17(a), 15 U.S.C. § 77q(a) (1964). The Exchange Act's provision is found in § 10(b), 15 U.S.C. § 78j(b) (1964) and is interpreted by Rule 10B-5, 17 C.F.R. § 240.10b-5 (1969). See notes 14, 22, 23 *infra*, for text of these provisions.

4. See *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) (the leading case holding that an implied civil action arises for a violation of the securities acts). See also, Note, *Implied Causes of Action from Federal Statutes*, 77 HARV. L. REV. 285 (1963).

5. For a general discussion of the measure of compensatory damages recoverable in an implied civil action, see Note, *Measurement of Damages in Private Actions under Rule 10b-5*, WASH. L.Q. 164 (1968).

6. 418 F.2d 1276 (2d Cir. 1969).

7. 302 F. Supp. 647 (D. Colo. 1969).

Exchange Act of 1934, it is necessary to consider the background and general scope of these statutes.

II. THE STATUTORY SCHEME OF SECURITIES REGULATION

The Securities Act of 1933 is designed primarily to regulate the procedures involved in the public issuance of securities.⁸ Those securities which are offered through the mails or through channels of interstate commerce are within the purview of the statute.⁹

Basically the Securities Act establishes requirements for disclosures which must be followed by the issuer. These requirements fundamentally include a registration statement filed by the issuer with the Securities and Exchange Commission.¹⁰ This statement must contain certain information concerning the forthcoming issue of securities.¹¹ The Act also requires that a prospectus containing the basic information in the registration statement be made available to prospective buyers of the security to be issued.¹² The failure to honestly represent the material facts in either the registration statement or the prospectus renders the issuer open to both civil and criminal liability.¹³ The Act also contains a general anti-fraud section, section 17(a),¹⁴ which will be discussed later in conjunction with the Exchange Act of 1934.

The Exchange Act of 1934 deals with a wide range of subjects, but primarily it is geared to the regulation of the transfer of securities.

Whereas the 1933 Act is concerned primarily with the distribution process, the 1934 Act has to do with post distribu-

8. 1 L. LOSS, *SECURITIES REGULATION* 130 (2d ed. 1961).

9. *Id.*

10. 15 U.S.C. § 77f (1964). The Securities and Exchange Commission is hereinafter also referred to in the text as S.E.C.

11. See 15 U.S.C. § 77g (1964) and 17 C.F.R. § 230.401-417 (1969).

12. 1 L. LOSS, *supra* note 8. See also 15 U.S.C. § 77j (1964).

13. The criminal penalties for willful violations of the Securities Act are a fine of not more than \$5,000 or imprisonment for 5 years, or both. 15 U.S.C. § 77x (1964).

14. Securities Act § 17(a), 15 U.S.C. § 77q(a) (1964), provides:

(a) it shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

(1) to employ any device, scheme, or artifice to defraud, or
(2) to obtain money or property by means of any untrue statement of a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, 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.

tion trading. It has four basic purposes: to afford a measure of disclosure to people who buy and sell securities; to prevent and afford remedies for fraud in securities trading and manipulation of the markets; to regulate the securities markets; and to control the amount of the Nation's credit which goes into these markets.¹⁵

The Exchange Act basically requires that all national securities exchanges be registered with the S.E.C. unless specifically exempted.¹⁶ Other elements of the Act are: power of the S.E.C. to expel exchange members for violations of the Act;¹⁷ power of the S.E.C. to require certain trading procedures and practices to be maintained by the exchanges;¹⁸ and a requirement of registration with both the exchanges and the S.E.C. which is substantially similar to the statement required by the 1933 Act.¹⁹ The Exchange Act also regulates the solicitation of proxies of securities listed and registered on the exchanges.²⁰ In addition, there are provisions which regulate over-the-counter brokers and dealers in securities.²¹

As with the 1933 Act, the Exchange Act has a general anti-fraud provision, section 10(b).²² This section, together with its administrative companion regulation,²³ serves as the basis for an implied civil action under the 1934 Act.

An important distinction which might be drawn between these two acts concerns the nature of their general anti-fraud provisions. While section 17(a) of the Securities Act is concerned with fraudulent practices perpetrated by the seller upon the purchaser, section 10(b) of the Exchange Act is not so limited and embraces

15. 1 L. Loss, *supra* note 8, at 130-31.

16. 15 U.S.C. § 78f (1964).

17. 15 U.S.C. § 78s(3) (1964).

18. 15 U.S.C. § 78s(4) (b) (1964).

19. 15 U.S.C. § 78l(b) (1964).

20. 15 U.S.C. § 78n (1964).

21. 15 U.S.C. § 78o-3 (1964).

22. Exchange Act § 10(b), 15 U.S.C. § 78j(b) (1964), provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

23. Rule 10B-5, 17 C.F.R. § 240.10b-5 (1969), which implements § 10(b) of the Exchange Act, provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

fraudulent practices by either the buyer or the seller.²⁴ This distinction becomes highly relevant when consideration is given to the question of whether these acts should support a recovery of exemplary damages in an implied civil action.

Another significant distinction which may be made between these two acts concerns the contrasting savings clauses contained in each statute.²⁶ The clause contained in the Exchange Act, section 28(a), has been construed by the courts as limiting the plaintiff in an implied civil suit brought under the act to "actual" damages, thus precluding the possibility of exemplary damages.²⁷

Courts have interpreted these two acts as constituting a single comprehensive scheme of regulation.²⁸ The statutes have been considered *in pari materia* in their operation and application.²⁹ It has been stated that the two statutes are, ". . . as closely related as two nominally separate statutes could be."³⁰ Moreover, there is a provision in the Exchange Act³¹ which provides that a willful violation of the 1933 Act constitutes an automatic breach of the 1934 Act.³² The interrelation between these Acts is of great significance

24. There have been various interpretations given for the differing nature of these sections, all centered on the presumed congressional intent present at the time of the legislative enactment. See discussion at notes 80-87 and accompanying text *infra*.

25. This is a basic issue present in both *Globus v. Law Research Service Inc.*, 418 F.2d 1276 (2d Cir. 1969), and *de Haas v. Empire Petroleum, Inc.*, 302 F. Supp. 647 (D. Colo. 1969). The distinction is relevant because common justice would appear to dictate that similar fraudulent conduct whether engaged in by the seller or buyer should result in identical legal liabilities.

26. The savings clause of the Securities Act, § 16, 15 U.S.C. § 77p (1964), states, "The rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity." Exchange Act § 28(a), 15 U.S.C. § 78bb(a), and its savings clause, provides in part that, ". . . no person permitted to maintain a suit for damages under the provisions of this chapter shall recover . . . a total amount in excess of his actual damages on account of the act complained of."

27. See, e.g., *Green v. Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968); *Meisel v. North Jersey Trust Co.*, 216 F. Supp. 469 (S.D.N.Y. 1963).

28. See, e.g., *Brown v. Gilligan Will & Co.*, 287 F. Supp. 766, 775 (S.D.N.Y. 1968); *Lennerth v. Mendenhall*, 234 F. Supp. 59, 62 (N.D. Ohio 1964); *United States v. Morgan*, 118 F. Supp. 621, 691 (S.D.N.Y. 1953); *Rosenberg v. Globe Aircraft Corp.*, 80 F. Supp. 123 (E.D. Pa. 1948).

29. *Brown v. Gilligan Will & Co.*, 287 F. Supp. 766, 775 (S.D.N.Y. 1968); *United States v. Morgan*, 118 F. Supp. 621, 691 (S.D.N.Y. 1953).

30. 6 L. Loss, *supra* note 8 at 3915.

31. 15 U.S.C. § 78o(b) (1964).

32. This provision deals with the revocation of the registration of any broker or dealer, if after an appropriate hearing the Commission determines that the revocation is in the public interest and has made a determination that the broker or dealer ". . . (D) has willfully violated any

when consideration is given to the question of whether punitive damages should be allowed under these statutes. For example, it may be possible for a single fraudulent practice to be simultaneously prescribed by both acts³³ in which case the statutes should be construed as allowing similar remedies.³⁴

Having examined the applicable fraud provisions and their interrelationship, the consideration now is whether exemplary damages may be recovered in an implied civil action under one or both of these statutes.

III. THE TRADITIONAL DICHOTOMY

Whether exemplary damages are available in an implied action under either section 10(b) or section 17(a) has been a continuing legal problem. In deciding the question the courts have traditionally drawn a distinction between the 1934 Act and its 1933 predecessor. This distinction has been based primarily on the presence of section 28(a) in the Exchange Act.³⁵

*Mills v. Sarjem Corp.*³⁶ was among the earliest cases to consider whether an implied section 10(b), Rule 10B-5 action would support an award of punitive damages. *Mills* involved an action brought by former stockholders who alleged that the corporation which purchased their interests did so through fraudulent misrepresentations violative of section 10(b) of the 1934 Act.³⁷ The plaintiffs sought exemplary damages.

The *Mills* court dismissed the count seeking exemplary damages, by ruling that section 28(a) precluded all but "actual" damages.³⁸ The court did not elaborate, but rather held that an implied civil action brought under section 10(b) and Rule 10B-5 of the Exchange Act would be limited to the recovery of "actual" damages.

The question of exemplary damages arose also in *Green v.*

provision of the Securities Act of 1933, or of this chapter, or of any rule or regulation thereunder." *Id.*

33. An example of such a situation occurred in *Globus v. Law Research Service, Inc.*, 418 F.2d 1276 (2d Cir. 1969), where the fraudulent conduct constituted a violation of both securities acts.

34. "Allowing exemplary damages under the 1933 but not the 1934 Act would create an unreasoned split between buyers and sellers of securities subjected to fraud of an equally heinous nature." *Globus v. Law Research Service, Inc.*, 418 F.2d 1276 (2d Cir. 1969). For a further discussion of the parity of remedies allowed under each act, see notes 35-54 and accompanying text *infra*.

35. See note 26 *supra*. Section 28(a) of the Exchange Act, 15 U.S.C. §§ 78a-hh (1964), has been interpreted as precluding all but compensatory damages in an action brought under that statute. The Securities Act has no comparable limitation and has been interpreted as allowing exemplary damages. See *Green v. Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968).

36. 133 F. Supp. 753 (D.N.J. 1955).

37. *Id.* at 759.

38. *Id.* at 770.

*Wolf Corp.*³⁹ As was the case in *Mills*, the court was specifically called upon to rule whether 10(b) and Rule 10B-5 would support exemplary damages. The Court of Appeals considered that the policy factors underlying an award of punitive damages,⁴⁰ coupled with the presence of section 28(a), disallowed the award of anything in excess of actual damages.⁴¹

In dictum the *Green* court stated that, ". . . punitive damages are permitted under the Securities Act of 1933, but that Act does not contain language similar to section 28(a) of the 1934 Act."⁴² In attempting to rationalize this inconsistency between the two statutes, the court continued:

Congress might well have intended to impose different liabilities under each of the two Acts since at the time of its enactment the requirements of the 1934 Act could have been avoided if the corporation simply refused to register on the exchanges. The provisions of the 1933 Act were less easily evaded. Hence, lighter penalties under the 1934 Act would have been an inducement for corporations to comply with its terms. . . .⁴³

This view as to section 10(b) and Rule 10B-5 of the 1934 Act has been followed by several other courts.⁴⁴

In *Myzel v. Fields*⁴⁵ the Court of Appeals again considered the effect of section 28(a) of the 1934 Act. There the court stated, ". . . we feel the only effect of this provision is to prohibit punitive damages, which might otherwise be available in some states in civil actions under the Securities Exchange Act of 1934."⁴⁶ Here again the court interpreted section 28(a) as precluding exemplary damages in an implied civil action.

In an action brought solely under the 1933 Act most courts traditionally would not deny the recovery of punitive damages.⁴⁷ In *Nagel v. Prescott & Company*⁴⁸ the purchasers of stock sued

39. 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 37 U.S.L.W. 3493 (1969).

40. For a discussion of these factors which appear in the *Globus v. Law Research Service, Inc.*, 418 F.2d 1276 (2d Cir. 1969), see notes 84-93 and accompanying text *infra*.

41. 406 F.2d at 302.

42. *Id.* at 303.

43. *Id.*

44. *Pappas v. Moss*, 257 F. Supp. 345 (S.D.N.Y. 1966), *rev'd on other grounds*, 393 F.2d 865 (3d Cir. 1968); *Meisel v. North Jersey Trust Co.*, 216 F. Supp. 469 (S.D.N.Y. 1963).

45. 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 88 Sup. Ct. 1043 (1968).

46. 386 F.2d at 748.

47. See, e.g., *Green v. Wolf Corporation*, 406 F.2d 291, 303 (2d Cir. 1968), *cert. denied*, 37 U.S.L.W. 3493 (1969); *Nagel v. Prescott & Company*, 36 F.R.D. 445 (N.D. Ohio 1964).

48. 36 F.R.D. 445 (N.D. Ohio 1964).

under the 1933 Act's fraud provisions alleging that the securities were sold under the fraudulent misrepresentation that they would produce an imminent windfall. The *Nagel* court concluded that, "although there is no provision in the Securities Act authorizing recovery of punitive damages, it is clear that the plaintiffs may recover upon a proper showing of maliciously improper conduct."⁴⁹

The *Nagel* court reached this conclusion by viewing the savings clause of the 1933 Act⁵⁰ as preserving for the plaintiff all other rights and remedies he may have enjoyed under state law.⁵¹ The court viewed the case within the framework of local Ohio law and concluded that the plaintiff was entitled to exemplary damages. The key fact which lead the *Nagel* court to rule that punitive damages might be recoverable was the showing of the requisite scienter by the plaintiff. "Recovery of exemplary damages hinges upon the plaintiff's ability to prove that the defendants were motivated by actual malice in allegedly misrepresenting the investment picture to the plaintiff."⁵²

The courts, then, have consistently drawn a distinction between the quality of damages available under either act. The distinction drawn basically stems from the interpretation given to the respective savings clauses.⁵³ The distinction is unfortunate because it fosters the existence of an unbalanced arsenal of remedies favoring the purchaser. Since the remedies under the 1933 Act apply solely to *purchasers*, the allowance of punitive damages under the 1933 Act gives the purchaser an added remedy not available to the seller under the 1934 Act. In effect the same fraudulent conduct by either the purchaser or the seller would result in differing legal consequences.⁵⁴

IV. THE EMERGING ALTERNATIVES

A. *Punitive Damages Recoverable Under Both Acts*

There appear to be two distinct and divergent views as to the recovery of punitive damages which are emerging from the recent cases. These cases share the common goal of attempting to alleviate the inconsistency which has arisen in an implied civil action under section 10(b) or Rule 10B-5 of the 1934 Act and section 17(a) of the 1933 Act.

The first view is exemplified by *de Haas v. Empire Petroleum*

49. *Id.* at 449.

50. Securities Act § 16, 15 U.S.C. § 77p (1964).

51. 36 F.R.D. at 449.

52. *Id.*

53. The courts have interpreted § 16 of the Securities Act, 15 U.S.C. § 77p (1964), as broad enough to allow exemplary damages. For the actual text of the respective savings clauses, see note 26 *supra*.

54. *Globus v. Law Research Services, Inc.*, 418 F.2d 1276 (2d Cir. 1969); *de Haas v. Empire Petroleum, Inc.*, 302 F. Supp. 647 (D. Colo. 1969).

*Inc.*⁵⁵ In this case a District Court was faced with the question of whether punitive damages could be available to a plaintiff in an implied civil action under Rule 10B-5 of the 1934 Act. The court also considered the effect of section 28(a) of that statute.

The court, in ruling that section 28(a) does not restrict the type of damages recoverable, concluded that punitive damages could be awarded in an action under Rule 10B-5: "We interpret this limitation as applying only to claims for relief which are expressly or impliedly created by the *Act itself*."⁵⁶ The *de Haas* court, in arriving at its decision placed great emphasis on the special nature of an implied civil action derived from Rule 10B-5. It held that such an action was based primarily on general tort law principles and consequently could not be considered as being created by the Act itself.⁵⁷

The *de Haas* court cited *Kardon v. National Gypsum Co.*⁵⁸ as being the leading case on the question of whether a civil action lies for a violation of Rule 10B-5. *Kardon* held that regardless of the absence of express statutory authorization, a civil action will arise in favor of the wronged party based on the general tort principle that the doing of an act prohibited by statute may give rise to an actionable wrong.⁵⁹

That a plaintiff may bring a civil action based upon a violation of 10(b) or Rule 10B-5 apparently is well settled.⁶⁰ Implicit in the cases permitting such civil actions is the rationale stated by the *Kardon* court.⁶¹ Hence it is seen that the *de Haas* case relied on the independent nature of the civil cause of action, namely its derivation from a source other than the 1934 Act, in granting punitive damages.

In its interpretation of section 28(a) the *de Haas* court relied strongly on *Hecht v. Harris, Upham & Co.*⁶² The *Hecht* case involved alleged violations of both statutes. The court, however, was

55. 302 F. Supp. 647 (D. Colo. 1969).

56. *Id.* at 649.

57. *Id.*

58. 69 F. Supp. 512 (E.D. Pa. 1946).

59. *Id.* at 513. See also RESTATEMENT (SECOND) OF TORTS: §§ 286-288c (1965) (wherein the concept of a violation of a statute will give rise to an actionable wrong).

60. For a full discussion of all the cases see Annot., 37 A.L.R.2d 649 (1954) (wherein the editors conclude that although the United States Supreme Court has yet to decide whether an implied civil remedy is available to a plaintiff under Rule 10B-5, the lower federal judiciary have unanimously upheld such an action).

61. See note 60 *supra*.

62. 283 F. Supp. 417 (N.D. Calif. 1968).

called upon to specifically decide the effect of section 28(a) on the recoverability of punitive damages in an implied civil action under Rule 10B-5. The court stated:

We are inclined to view that the restrictive provisions of Section 28(a) . . . concerning "actual damages" were intended by the Congress to apply to those statutory causes of action which it specifically "permitted" in the Acts—but not to other rights of action based upon the general law of tortious injury and that exemplary damages could be awarded in the pending action.⁶³

In *Baumel v. Rosen*⁶⁴ the court gave a similar interpretation to section 28(a). There the court stated, ". . . Sec. 28(a), by its terms, appears to be applicable only to suits specifically authorized by the 1934 Act. . . ."⁶⁵ In a civil action not specifically authorized by the 1934 Act, the *Baumel* court would most probably hold section 28(a) inapplicable, thus opening the possibility of exemplary damages.

The above decisions, then, have attempted to eliminate the disparity between the 1934 Act and its 1933 predecessor by *allowing* exemplary damages under the former statute. This result is accomplished by construing the implied action under Rule 10B-5 as not within the limitation of section 28(a) of the 1934 Act.

B. Complete Disallowance of Punitive Damages

In the recent decision of *Globus v. Law Research Service, Inc.*⁶⁶ the Second Circuit has responded to the disparity in the damages recoverable in an implied civil action brought under both securities acts by holding that neither act will support a recovery of exemplary damages.⁶⁷

In *Globus* the court was faced with the precise question of whether section 17(a) of the 1933 Act could support an award of punitive damages. The case involved an action by purchasers of the stock of Law Research Services, Inc. (LRS), against LRS and the underwriter of the public offer. The plaintiffs alleged violations of various sections of both the 1933 and 1934 Securities Acts, including section 17(a) of the 1933 statute,⁶⁸ in addition to a count based on common law fraud.

At trial the jury decided in favor of the defendants as to the

63. *Id.* at 445. See also, *Stevens v. Proctor & Paine*, 288 F. Supp. 836 (E.D. Va. 1968).

64. 283 F. Supp. 128 (D. Md. 1968) (this case involved a pure Rule 10B-5 action).

65. *Id.* at 145. The court was not considering the issue of whether exemplary damages should be allowed, but rather was considering the proper measure of compensatory damages.

66. 418 F.2d 1276 (2d Cir. 1969).

67. *Id.* at 1286; see *Green v. Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968), where this court also held that a Rule 10B-5 implied civil action will not support a recovery of exemplary damages.

68. 418 F.2d at 1278.

common law fraud count, but also decided that the defendants were in violation of both securities acts.⁶⁹ The trial judge ruled that punitive damages were properly available in an implied action under section 17(a).⁷⁰ The defendant appealed. The Circuit Court held that it was error to allow punitive damages under section 17(a),⁷¹ reversing the lower court on this issue. The court reasoned that Congress most probably intended section 17(a) to serve as the basis for a criminal or injunctive action.⁷² It recognized that all the express civil remedies under the Act limit themselves to compensatory damages.⁷³ It also stated that notwithstanding the controversy which still surrounds the recoverability of civil compensatory damages under section 17(a), a recovery of punitive damages would most surely "jolt and startle" the draftsmen of the 1933 Act.⁷⁴

Underlying the seminal question of whether punitive damages should be available in an implied 17(a) action were the fundamental questions of the general propriety of exemplary damages in this type of action and the advisability of the court perpetuating the disparity between the 1933 and 1934 Acts. The *Globus* court ruled in the negative as to both points.

Globus, then, represents a position opposite to that taken by the court in *de Haas v. Empire Petroleum Inc.*⁷⁵ However, both cases share the common ground of attempting to eliminate the disparity between the two acts. Where their views radically clash is in the recognition and value given to the policy factors underlying the issue of whether exemplary damages should be awarded in implied civil actions.

Finally it must be emphasized that the *Globus* court expressly declined to rule on the question of whether punitive damages were recoverable in a common law fraud action which is joined in an action based on a violation of the 1933 and 1934 Acts.⁷⁶

69. *Id.* at 1279.

70. *Id.*

71. *Id.* at 1286.

72. *Id.* See also 3 L. Loss, *supra* note 8 at 1784-85 (1961); Douglas, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 181-2 (1933); Note, *Federal Regulation of Securities: Some Problems of Civil Liability*, 48 HARV. L. REV. 107 (1934).

73. 15 U.S.C. §§ 77k(e), 77l(2) (1964).

74. 418 F.2d at 1284.

75. 302 F. Supp. 647 (D. Colo. 1969).

76. "Because the jury found the defendants not liable on the common law fraud count, we also do not reach the question of whether § 28(a) would prohibit punitive damages in an action for common law fraud. . . ." 418 F.2d 1276, 1286 n.11. The basic distinction between a fraud action at common law and one brought under the Securities Act was stated by the

V. POLICY FACTORS IN GLOBUS

The lower court in the *Globus* case held in favor of retaining the distinction between the two acts, thus allowing punitive damages under section 17(a) of the 1933 act.⁷⁷ The court reasoned that the disparity between the two acts, namely the presence of section 28(a) in the 1934 Act, was part of the general statutory scheme intended by Congress.⁷⁸ The court stated that,

[s]ince the 1934 Exchange Act was to apply only to post-distribution trading of securities listed on the national exchanges, issuers could avoid its provisions, at least as far as new issues were concerned, simply by not listing them with the national exchanges.⁷⁹

The possibility of easy avoidance, the court reasoned, prompted Congress to expressly limit the remedies available to the plaintiff. The device was a form of lure by which the Congress attempted to expand the applicability of the 1934 Act.⁸⁰

The lower court in *Globus* also concluded that the policy factors underlying the awarding of punitive damages were present in the instant case. First, the lower court stated that the award of punitive damages has been a useful tool in deterring fraudulent conduct of a "heinous character." The court stated that Congress had expressly declared war upon dealers in securities who would deceive investors, and to this end equipped the Securities and Exchange Commission, the Department of Justice, and the investing public, with an arsenal of legal weapons designed to instill honesty and fair dealing among issuers, underwriters, and others who deal in securities.⁸¹

The court also thought that punitive damages would be appropriate in the circumstances where the amount recoverable in actual damages might be small and of insufficient quantity to render the plaintiff completely whole.⁸² Moreover, in certain cir-

trial court in *Globus v. Law Research Service, Inc.*, 287 F. Supp. 188 (S.D.N.Y. 1968). For a plaintiff to maintain successful common law fraud action it is necessary for him to

... establish (1) justifiable reliance, necessary in a common law deceit action, rather than the federal securities law fraud's actual reliance test, i.e., that the plaintiff would have been influenced to act differently than he did if the defendant had disclosed the omitted fact; and (2) a specific "intent to defraud" as distinguished from actual knowledge of a statement's material falsity or of facts showing it to be false or misleading, notwithstanding the existence of a general fraudulent purpose aimed at the public as a whole, or wanton and reckless conduct evidencing a deliberate disregard for one's own obligations or the interest of others.

Id. at 195.

77. 287 F. Supp. at 196.

78. *Id.* at 193-94.

79. *Id.*

80. *Id.* at 194.

81. *Id.* at 194-95.

82. The court stated:

In addition to deterring fraud generally in the sale of securities, punitive damages serve the desirable function, certainly in

cumstances it would be entirely unjust to limit a recovery to compensatory damages. Unscrupulous dealers may actually consider the amount of their possible liability in compensatory damages as a "cost" of illicit business.⁸³

The Circuit Court countered these arguments most effectively when it considered the entire battery of remedies available to the plaintiff under section 17(a) of the 1933 Act.⁸⁴ The appellate court noted the fact that the 1933 Act not only provides for stiff fines and criminal penalties for violation of section 17(a),⁸⁵ but also authorizes the S.E.C. to suspend or expel from the trading exchanges those who violate the securities laws. Recognition was given to the fact that, notwithstanding the elimination of punitive damages as a remedy, large substantial recoveries of compensatory damages might still be available to the plaintiff.⁸⁶ The awarding of punitive damages, then, was considered by the appellate court to have but a mere marginal deterrent effect.⁸⁷

The court also thought that any potential for deterrence should be weighed against the possible adverse consequences of awarding this type of recovery.⁸⁸ One such consequence concerns the impossibility of the court reasonably limiting the amount of punitive damages a jury might award.⁸⁹ The court analogized this situation

cases involving limited amounts of compensatory damages (such as that here) of insuring that victims of a scheme to defraud who purchased only a small number of shares pursuant to a Regulation A offering . . . so that they will not find themselves without an effective legal remedy.

Id. at 195.

83. *Id.* See also *Walker v. Sheldon*, 10 N.Y.2d 401, 179 N.E.2d 497, 223 N.Y.S.2d 488 (1961), where the court declared that limiting the judgment to compensatory damages

would require the offender to do no more than return the money which he has taken from the plaintiff. In the calculation of his expected profits, the wrongdoer is likely to allow for a certain amount of money which will have to be returned to those victims who object too vigorously, and he will be perfectly content to bear the additional cost of litigation as the price for continuing his illicit business.

Id. at 492, 179 N.E.2d at 499.

84. 418 F.2d 1276, 1284 (2d Cir. 1969).

85. 15 U.S.C. § 77x (1964) (wherein a 5 year prison term is provided).

86. 418 F.2d at 1285. See also *Green v. Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968). Consideration should be given to the possibility of bringing a class action by virtue of FED. R. Civ. P. 23.

87. 418 F.2d at 1285.

88. *Id.*

89. The court stated that normally punitive damages were available in actions by a *single* injured party thus keeping the damages to a reasonable level. The court stated, "A single misstatement in a prospectus or offering circular . . . may make those liable to literally thousands of purchasers." *Id.*

to the factual situation in *Roginski v. Richardson Merrell Inc.*⁹⁰ In *Roginski* the court denied punitive damages in a class action against a drug company which was negligent in the marketing of a harmful drug. *Roginski* also emphasized the principle that punitive damages should be limited to a reasonable award in an action brought by an individual.⁹¹

Thus *Globus*, in an attempt to eliminate the apparent dichotomy present in the remedies available under the 1933 and 1934 Acts, has recognized as a desirable policy the equalization of the remedies available under both Acts:⁹² "Allowing exemplary damages under the 1933, but not the 1934 Act would create an unreasonable split between buyers and sellers of securities subjected to fraud of an equally heinous nature."⁹³

VI. A COMPARISON OF DE HAAS AND GLOBUS

As illustrated by both *de Haas v. Empire Petroleum Inc.*⁹⁴ and *Globus v. Law Research Services, Inc.*,⁹⁵ the courts have recognized and attempted to eliminate the disparity present between the two securities acts in the area of implied civil remedies.

Naturally, factual distinctions may be drawn between these two decisions. *De Haas* involved an action brought solely under section 10(b) and Rule 10B-5 of the 1934 Act, while *Globus* involved a compound section 10(b), Rule 10B-5 and section 17(a) action. Notwithstanding their differing remedial bases, these cases share the common ground of considering the issue of whether an implied civil action brought under securities acts will support the recovery of exemplary damages. Basically, then, a comparison of the relative merit of these decisions must rest upon the general propriety of exemplary damages in an implied action under the Acts.

In considering whether the recovery of punitive damages is proper in an implied civil action, analogous cases offer only limited assistance. Although there are cases in which the court has not hesitated to allow the recovery of punitive damages in actions implied by the provisions of specific statutes,⁹⁶ other cases have

90. 378 F.2d 832 (2d Cir. 1967).

91. See note 89 *supra*.

92. 418 F.2d 1276, 1286 (2d Cir. 1969).

93. *Id.*

94. 302 F. Supp. 647 (D. Colo. 1969).

95. 418 F.2d 1276 (2d Cir. 1969).

96. See, e.g., *Mansell v. Saunders*, 372 F.2d 573, 576 (5th Cir. 1967) (punitive damages recoverable in an action under the Civil Rights Act of 1871, 42 U.S.C. § 1983 (1964)); *Basista v. Weir*, 340 F.2d 76, 84-88 (3d Cir. 1965) (punitive damages recoverable under Civil Rights Act of 1871, 42 U.S.C. § 1983 (1964)); *In re Den Norshe Amerikanlinje A/S*, 276 F. Supp. 163, 176 (N.D. Ohio 1967) (punitive damages recoverable in an action under the Jones Act, 46 U.S.C. § 688 (1964)); *Wills v. Trans American Air Lines*, 200 F. Supp. 360 (S.D. Cal. 1960) (punitive damages recoverable in an

reached a contrary result.⁹⁷

The courts in both the *United Mine Workers v. Patton*⁹⁸ and the *Burris v. International Brotherhood of Teamsters*⁹⁹ used the rationale that punitive damages should not be allowed in an implied civil action brought under the statute absent express congressional mandate.¹⁰⁰ As stated in *Patton*,

. . . When Congress has intended that damages in excess of the actual damages sustained by the plaintiff may be recovered in an action created by statute, it has found no difficulty in using language appropriate to that end.¹⁰¹

Since there is no "express congressional intent" in an implied civil action, the above view would not consider punitive damages available.

The appellate court's decision in *Globus* seems to offer a more concrete approach to the question of the availability of punitive damages. The court considered the role that punitive damages might play in the scheme of regulation established for the specific enforcement of the 1933 Act.¹⁰² At the inception of the 1933 Act most commentators and members of the S.E.C. thought section 17(a) would serve only as the basis for criminal or injunctive actions.¹⁰³ Civil liability was presumed limited to the express provisions of sections 11 and 12 of the 1933 Act. Sections 11 and 12, which create express civil remedies, limit recoveries to compensatory damages.¹⁰⁴

Considering the probable intent of the Congress in passing section 17(a) and the subsequent judicial interpretations which have been given to this section, the court stated,

[s]ince even in this day of easily implied liability under the securities acts, it is not settled to everyone's satisfaction that compensatory damages are authorized by Sec. 17(a), it would no doubt jolt and startle the draftsmen of the 1933

action under the Federal Aviation Act of 1958, §§ 404b, 902(a), 49 U.S.C. §§ 1374(b), 1472(a) (1964)).

97. See, e.g., *United Mine Workers v. Patton*, 211 F.2d 742 (4th Cir. 1954), cert. denied, 348 U.S. 824 (1954) (involving an action brought under a federal labor statute); *Burris v. International Brotherhood of Teamsters*, 224 F. Supp. 277 (W.D.N.C. 1963) (action based upon violation of the Labor-Management Disclosure Act of 1959).

98. 211 F.2d 742 (4th Cir. 1954), cert. denied, 348 U.S. 824 (1954).

99. 224 F.Supp. 277 (W.D.N.C. 1963).

100. 211 F.2d 742, 750 (4th Cir. 1954), cert. denied, 348 U.S. 824 (1954); 224 F. Supp. 277, 280 (W.D.N.C. 1963).

101. 211 F.2d at 749.

102. 418 F.2d 1276, 1284 (2d Cir. 1969).

103. See authorities cited in note 72 *supra*.

104. These sections are concerned with misrepresentations appearing in the perspective and the registration statement respectively.

Act to be told that they also authorized the recovery of punitive damages when that section was formulated.¹⁰⁵ With this statement the court refused to adopt the interpretation given to section 17(a) by the lower court.¹⁰⁶ The court then weighed the factor of whether the recovery of punitive damages was necessary for the effective enforcement of the Act and concluded that the policy factors indicated a negative answer.¹⁰⁷

The *de Haas* court approached the dichotomy from an entirely different frame of reference. Relying solely upon an interpretation of section 28(a) of the 1934 Act, which limited the sections' application to actions "expressly authorized by the Act," the court applied a traditional tort approach.¹⁰⁸ The violation of the statute was considered by the court to imply the civil remedy.¹⁰⁹ Because the court was faced with an "implied" remedy, section 28(a) was deemed inapplicable, thus creating the legal foothold necessary to support the award of exemplary damages.

The *de Haas* court apparently ignored the strong policy factors present against the imposition of exemplary damages which played a large role in the *Globus* decision.¹¹⁰ The court in *de Haas* relied entirely on the theoretical legal basis mentioned above.¹¹¹ It is submitted that the *Globus* case which relied heavily on practical considerations and the policy factors involved, should predominate as the better view.

VII. CONCLUSION

It is submitted that, in an implied civil action under either the Securities Act of 1933 or the Exchange Act of 1934, the recovery of punitive damages should not be allowed. The primary reason that punitive damages are imposed is to punish the wrongdoer. This punishment is theoretically designed to further the policy of deterring the undesirable conduct. As has been previously noted,¹¹² there are harsh penalties expressly provided by the securities acts. These penalties whether they constitute criminal sanctions, injunctive action, or civil liabilities, serve as an effective deterrent to fraudulent practices. The further imposition of punitive damages can have but a marginal effect on increasing this deterrent, while creating a situation where unreasonably excessive recoveries might be fostered. Finally, considering the policy factors involved,¹¹³

105. 418 F.2d 1276, 1284 (2d Cir. 1969).

106. *Id.* at 1286.

107. *Id.*

108. The court adopted a view consistent with that stated in RESTATEMENT (SECOND) OF TORTS §§ 286-288c (1965). See note 60 *supra*.

109. 302 F. Supp. 647, 650 (D. Colo. 1969).

110. The court considered the pure legal question of whether a violation of this particular statute would create a civil remedy.

111. See note 110 *supra*.

112. See text and accompanying notes 10-27 *supra*.

113. See text and accompanying notes 77-93 *supra*.

and the apparent regulatory scheme expressly adopted by Congress,¹¹⁴ the recovery of punitive damages seems unwarranted.¹¹⁵

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114. See text and accompanying notes 105-07 *supra*.

115. During the publication stages of this Comment, the United States Supreme Court denied certiorari in *Globus v. Law Research Service, Inc.*, 38 U.S.L.W. 3320 (1970).