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PUNITIVE DAMAGE AWARDS UNDER
THE FEDERAL SECURITIES ACTS

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and  
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During the past several years, plaintiffs in civil actions under the Securities Act of 1933 (the “1933 Act”)¹ and the Securities Exchange Act of 1934 (the “1934 Act”)² have sought punitive damages.³ While punitive damages are granted in certain common law tort actions, for a brief interlude there was a split of authority between a federal district court and federal circuit court as to punitive damage awards under the federal securities acts. A recent decision has, for the present, resolved the conflict. In that recent decision, the Tenth Circuit Court of Appeals reversed the Colorado District Court in deHaas v. Empire Petroleum Co.⁴ and held that punitive damages cannot be awarded in actions brought under rule 10b-5 of the 1934 Act. The Second Circuit Court of Appeals had earlier decided that punitive damages could not be recovered in actions under the 1934 Act in Green v. Wolf Corporation⁵ and reached the same con-

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³ Punitive damages may be awarded in civil cases to plaintiffs over and above their actual losses where the wrongdoer’s conduct is outrageous, malicious and deliberate or reckless and wanton. Similar in function to the penalties imposed under the criminal law, punitive damages are intended to punish the wrongdoer and deter him and others from committing similar acts in the future. Punitive damages are also termed “exemplary damages” or “smart money.”  
⁵ 17 C.F.R. § 240.10b-5 (1971):  
It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce, or of the mails, or of 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 or to omit to state 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.  
clusion with respect to actions under the 1933 Act in *Globus v. Law Research Service, Inc.*

**I. Recent Cases**

In the *Green* case, the plaintiff brought an action under § 10(b) of the 1934 Act and rule 10b-5 thereunder alleging that there were untrue or misleading statements in three different prospectuses of the Wolf Corporation distributed to the public in 1961 and 1962. When the district court struck that portion of the plaintiff's complaint which sought punitive damages, Green appealed to the Second Circuit which held that punitive damages cannot be recovered in actions under § 10(b) or rule 10b-5 because § 28(a) of the 1934 Act provides that any person who maintains a suit for damages under the 1934 Act is prohibited from recovering an amount in excess of his actual damages. The Court did "not believe that Congress intended the '... [1934] Act to be used as a vehicle for the recovery of judgments that could often be grossly disproportionate to the harm done."  

The *Globus* case involved Law Research Service, Inc. ("LRS"), organized in 1963 to facilitate legal research by the use of computers. In order to have

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**F.2d 369 (3d Cir. 1956); Mills v. Sarjem Corp., 133 F.Supp. 753 (D.N.J. 1955).** The *Green* case also involved the question of when a class action for a rule 10b-5 violation is permitted, 406 F.2d at 295-301.  

**7** 418 F.2d 1276 (2d Cir. 1969), cert. denied, 397 U.S. 913 (1970), rev'g on the issue of punitive damages and aff'd in all other respects, 287 F.Supp. 188 (S.D.N.Y. 1968). Contra: Nagel v. Prescott & Co., 36 F.R.D. 445, 449 (N.D. Ohio 1964) (dictum). The *Globus* case also held that it was against public policy to permit an underwriter to recover on an indemnification agreement which provided that the issuer would indemnify the underwriter for any liability arising out of an untrue statement of a material fact, 418 F.2d at 1287-89.  


That 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:  


(a) The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this title shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder (emphasis supplied).  

**10** 406 F.2d at 303. Of course, since the case was appealed after the order striking portions of the complaint and before a trial could be had, the Second Circuit never passed upon the question as to whether the type of conduct alleged in the complaint would warrant a punitive damage award.

The Second Circuit's opinions in the *Green* and *Globus* cases were written by Judge Irving R. Kaufman. In the course of the *Green* opinion, Judge Kaufman set forth the dictum "that punitive damages ... [recoveries] are permitted under the Securities Act of 1933," 406 F.2d at 303, citing the trial judge's opinion in *Globus*, 287 F.Supp. 188 (S.D.N.Y. 1968). In the *Globus* opinion, Judge Kaufman wrote (in a footnote) that it should have been "obvious to the careful reader that this was merely dicta," 418 F.2d at 1286 (emphasis supplied).
the necessary equipment to bring the concept to fruition, LRS entered into a five-year contract with the computer division of the Sperry Rand Corporation ("Sperry"). In its early months of operation, LRS began to accumulate substantial debts and in order to raise new capital, 100,000 shares of LRS stock were offered to the public at $3 a share by means of an offering circular.\(^{11}\) Certain material facts, however, were omitted from the offering circular relating to a dispute between Sperry and LRS which resulted in Sperry refusing to permit LRS to use its computers to process inquiries and LRS in turn instituting a lawsuit against Sperry. The plaintiffs, purchasers of the LRS stock, brought their action against LRS, the president of LRS (who was also the principal stockholder) and the underwriter of the public offering, and were awarded compensatory damages totaling more than $32,000. In addition, there were punitive damage awards assessed against the president of LRS and the underwriter for approximately $27,000 and $13,000, respectively, for their violations of §17(a) of the 1933 Act\(^{12}\) in view of their fraudulent, wanton and reckless conduct involving those facts of which they were aware and yet failed to disclose to the public.\(^{13}\)

The trial judge thought that punitive damage awards would serve to deter the kind of fraudulent conduct which was present in the case and that punitive damage awards were in "accord . . . with the overall purpose of the anti-fraud provisions of the 1933 Act."\(^{14}\) The trial judge also believed that the absence in the 1933 Act of a provision similar to §28(a) of the 1934 Act indicated Congress' intention not to preclude punitive damage awards in actions under the 1933 Act.

On appeal, the Second Circuit expressed some concern over "... whether §17(a) standing alone would support an action for compensatory damages,"\(^{15}\) although courts have held that a private right of action lies for violation of §17(a) of the 1933 Act. The Second Circuit seemed to be indicating that since a defrauded buyer can bring an action either under §17(a), §10(b) or rule 10b-5, whereas a defrauded seller can only bring an action under the latter two pro-

\(^{11}\) An offering circular is required by Regulation A, 17 C.F.R. § 230.251-263 (1969), promulgated by the Securities and Exchange Commission ("SEC") pursuant to the grant of authority found in § 3(b) of the 1933 Act, 15 U.S.C. § 77c(b) (1964), which provides that offerings which do not exceed $300,000 (now $500,000) may be exempted in accordance with SEC rules. In providing for the offering circular under Regulation A, the SEC intended that the offering circular contain disclosure information similar to that which is required in a prospectus.

\(^{12}\) 15 U.S.C. § 77q(a) (1964):

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instrumentality 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 or any omission to state 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
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

\(^{13}\) While the complaint alleged that the defendants violated §17(a) of the 1933 Act and §10(b) of the 1954 Act (and included a count in common law fraud as well as charging the defendant underwriter with violations of §12(2) of the 1933 Act and §15(c) of the 1934 Act), the punitive damage award was based on a violation of §17(a) of the 1933 Act, 287 F.Supp. at 194.

\(^{14}\) 287 F. Supp. at 194.

\(^{15}\) 418 F.2d at 1283.
visions, all actions by defrauded buyers alleging a § 17(a) violation should be brought under § 10(b) and rule 10b-5. By doing this, all such actions would be subject to the actual damages limitation of § 28(a) and, thus, it would be possible to avoid the issue of punitive damage awards under the 1933 Act. But the Court was unable to follow this course because of the extensive case law which supports the view that there is a private right of action under § 17(a).

The Globus opinion rests on policy considerations. While the Second Circuit recognized that punitive damages would serve to punish wrongdoers and to deter violations of the 1933 Act, the court observed that there already exists an extensive “arsenal of weapons” under the federal securities acts which serves the functions of retribution and deterrence. For instance, there are criminal sanctions under the 1933 Act which provide for fines in addition to imprisonment. Also, the SEC has suspension and expulsion powers which can be employed against potential violators, and the SEC has authority to seek injunctions against deceptive practices. Furthermore, when procedural devices such as class actions are employed by victims of securities frauds, the multiplication of compensatory damages alone will have a potent deterrent effect (although no retributive effect).

The Second Circuit was also concerned that when a material misstatement was disseminated to the public and the harm was widespread, the addition of punitive damages to the arsenal “could well bankrupt an otherwise honest underwriter or issuer who egregiously erred in one instance.”

The Second Circuit’s final point is premised on the interrelation between the 1933 Act and 1934 Act. Since defrauded sellers of securities can only obtain relief under the 1934 Act and thus are subject to the actual damages limitation of § 28(a), if a defrauded purchaser could bring an action under § 17(a) of the 1933 Act and recover punitive damages, there would be an irrational dichotomy in the treatment of defrauded purchasers and sellers. The court noted that a prime objective of both the 1933 Act and the 1934 Act is to protect persons who are the victims of securities frauds, and for this reason, there should not be an irrational distinction between innocent purchasers and innocent sellers.

In deHaas v. Empire Petroleum Co., an action for violation of rule 10b-5,

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16 The SEC adopted rule 10b-5 in 1942 which incorporated the language of § 17(a) of the 1933 Act into the 1934 Act except that the language of rule 10b-5 was broadened to protect sellers as well as purchasers of securities. See 3 L. Loss, SECURITIES REGULATION 1761, 1785 (2d ed. 1961) [hereinafter cited as Loss]. See also SEC Securities Exchange Act Release No. 3230 (May 21, 1942), adopting rule 10b-5 (at that time X-10B-5).

17 See, e.g., Dauphin Corp. v. Redwall Corp., 201 F.Supp. 466, 469 (D. Del. 1962), where the court found it unnecessary to determine if a defrauded buyer could maintain an action under § 17(a) when the action could be brought under rule 10b-5.


19 418 F.2d at 1285.


21 See § 8(d) of the 1933 Act, 15 U.S.C. § 77h(d) (1964), power to issue stop orders suspending effectiveness of a registration statement; § 15(b) of the 1934 Act, 15 U.S.C. § 78o(b) (1964), power to censure, deny registration to, suspend or revoke the registration of any broker or dealer.


23 418 F.2d at 1285.
the Colorado District Court upheld a jury verdict which awarded punitive damages against the individual defendant in the case. In rejecting the contention that §28(a) barred recovery of punitive damages in a 10b-5 action and noting that the Second Circuit had ruled otherwise in the Green case, the district court held that the §28(a) limitation applies only to causes of action which are "expressly or impliedly created by the [1934] Act itself" and not to an action for damages based on a violation of rule 10b-5 which is an action grounded on the general tort law principle that the disregard of the command of a statute is a wrongful act and a tort. In reaching this decision, the district court took the position that Congress did not contemplate an implied right of action under rule 10b-5. This was necessary because if the district court had conceded that Congress contemplated actions under rule 10b-5, it would have been necessary to meet the contention that Congress intended that such an implied remedy should be subject to the actual damages limitation of §28(a).

On appeal, the Tenth Circuit reversed the punitive damage award and based its "holding upon an analysis of the policies underlying the [federal] securities laws and the awarding of punitive damages." Considering many of the same policy considerations which were discussed by the Second Circuit in the Globus opinion, the Tenth Circuit concluded "that punitive damages should not be allowed in a private action under [r]ule 10b-5."

II. Section 28(a) of the 1934 Act

In the Green case, the Second Circuit viewed the following language of §28(a) as the main obstacle to punitive damage awards under the 1934 Act:

[N]o person permitted to maintain a suit for damages under the provisions of [the 1934 Act] . . . shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. . . .

It has been suggested that this language is not intended to bar punitive damage awards under the 1934 Act; rather, it simply prohibits double recovery under a statutory remedy and a common law action for the same act. The actual damages limitation is juxtaposed to that portion of §28(a) which provides that the rights and remedies of the 1934 Act are in addition to all other remedies existing at law or in equity and there is the reference in §28(a) to "one or more actions." Thus, it can be argued that while Congress was preserving all legal and equitable remedies in addition to granting certain statutory remedies, it was careful to provide that this was not to be interpreted as permitting double recovery if two causes of action should be proved. The trial judge in the Globus

25 435 F.2d 1223, 1230 (10th Cir. 1970).
26 Id. at 1232.
case suggested that §28(a) was intended to prohibit both double recoveries and punitive damages.29

In the Green case, the Second Circuit assumed that the actual damages limitation of §28(a) applied to all actions brought under the 1934 Act and it did not distinguish (as the district court in the deHaas case did) between civil actions expressly authorized by the 1934 Act and civil actions which have been implied under the 1934 Act.30 As noted above, the district court in the deHaas case held that implied actions under the 1934 Act are grounded on the general tort law principle that the disregard of the command of a statute gives rise to civil liability if the intent of the statute is (1) to protect the interests of certain persons and (2) the interest invaded is the one which the statute is intended to protect.31 The Tenth Circuit did not attempt to resolve this question in the deHaas case and instead opted to decide the question on policy considerations alone.32

In support of the Second Circuit’s assumption that § 28(a) applies to implied actions under the 1934 Act, it has been pointed out that rule 10b-5 and other rules and regulations under the 1934 Act which have been held to support an implied right of action33 were adopted pursuant to grants of authority contained in various sections of the 1934 Act. Since all the sections of the 1934 Act are subject to the actual damages limitation of § 28(a), implied civil actions under these rules and regulations would seem to be subject to the same limitation as are the sections of the 1934 Act which authorize their adoption.34 On the other hand, it can be argued that § 28(a) may be interpreted as applying to only those suits for damages which are expressly authorized by the 1934 Act. For example, § 10(b) does not specifically authorize a suit for damages (whereas § 9(e), § 16(b) and § 18 of the 1934 Act do) and it seems difficult to argue that § 28(a), which applies to suits for damages authorized in the 1934 Act, applies to § 10(b). Nevertheless, it is interesting to compare § 28(a) with another provision of general applicability found in the 1934 Act, § 27.35 Section 27 basically provides that the federal district courts “shall have exclusive jurisdiction of violations of... [the 1934 Act] or the rules and regulations thereunder.” It is generally thought that implied rights of action under the 1934 Act cannot be maintained in state courts because of the exclusive jurisdiction provisions of § 27 and there is apparently no dichotomy of treatment between express and implied actions under § 27.36

29 287 F. Supp. at 196.
32 435 F.2d 1223, 1231 (10th Cir. 1970).
36 See generally 3 Loss 2005-6 (2d ed. 1961); A. Bromberg, Securities Law Fraud Rule
It has been suggested that one way to determine if § 28(a) is applicable to implied actions under the 1934 Act is to try to discover if Congress, in enacting the 1934 Act, contemplated or intended that § 28(a) should apply to implied as well as express actions under the 1934 Act.\(^7\) The difficulty with this suggestion is that it first becomes necessary to determine if Congress ever really intended or contemplated implied rights of action under the 1934 Act.\(^7\) There has been much dispute over this threshold problem, however, and the concept of an implied cause of action under a federal statute “is more likely to be hindered than helped when placed in the narrow context of a search for tokens of legislative intent.”\(^3^9\)

There is some question as to whether the courts have already been disregarding the “actual damages” limitation of § 28(a) in determining damages in implied actions under the 1934 Act. The courts have exercised broad discretion in this area,\(^4\) and in tailoring the damages to the particular facts of a case, the courts have sometimes gone beyond the actual damages suffered by the victim and awarded judgments in excess of the victim’s actual monetary loss. For example, in one case where a defendant had fraudulently induced the victim to convey to him certain property and had made a substantial profit from the property, the First Circuit Court of Appeals held that “[i]t is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them.”\(^4^1\) In another case, “the injured party ... [was] entitled to require the perpetrator to disgorge gains made at the expense of the injured.”\(^4^2\)

Thus, courts have been awarding damages in implied actions under the 1934 Act which are not solely compensatory in nature, and in this respect, the courts are already in open disregard of the actual damages limitation of § 28(a). Awarding punitive damages in implied actions would therefore present no open break with past practice.\(^4^3\) It should be pointed out, however, that there is a significant difference in degree between awarding punitive damages and forcing a fraudulent

\(^{10b-5}\) § 11.1 (1967). But note uncertainty as to whether a state court can consider a violation of the 1934 Act which is raised by way of defense, 2 Loss 977-99 (2nd ed. 1961).

See Analysis, May Punitive Damages Be Assessed Against Violators of the Federal Securities Acts?, 26 BNA SEC. REG. & L. REP. B-1, B-2 (1969). In the deHaas case, the Tenth Circuit reviewed the legislative history of Section 28(a) and found nothing helpful, 435 F.2d 1223, 1230 (10th Cir. 1970).

38 As noted above, the District Court in the deHaas case believed that Congress did not contemplate a private action for damages under rule 10b-5, 302 F.Supp. at 648.


43 It has been suggested that in requiring a 10b-5 violator to disgorge his gains, “the object is not merely to compensate the plaintiff but also to deter the defendant,” Note, Measurement of Damages in Private Actions Under Rule 10b-5, WASH. U.L.Q. 165, 171 (1968). In this respect, the courts are already searching for a tool with a deterrent effect. It would seem that the possibility of punitive damage awards would also serve that purpose.
party to disgorge profits. In the latter instance, the fraudulent party will be no worse off financially than he was prior to engaging in the fraudulent transaction, whereas he might very well be if punitive damages are assessed against him.

Notwithstanding the holdings of the Green and de Haas cases, a party suing in a federal court under rule 10b-5 could still obtain punitive damages by adding to his complaint a common law fraud count under the doctrine of pendent jurisdiction. While the plaintiff would only have to prevail on the 10b-5 action in order to obtain compensatory damages, he might have to show all the elements of common law fraud together with an indication of outrageous conduct in order to obtain punitive damages. It has been suggested that § 28(a) may extend beyond express or implied actions under the 1934 Act and may bar punitive damage recovery in a common law fraud action (or in an action under another federal statute) where such an action is joined with an express or implied action brought under the 1934 Act. But this seems to be a strained interpretation of § 28(a) in view of the first clause of § 28(a) which preserves all other rights and remedies that exist at law or in equity.

The presence of § 28(a) in the 1934 Act also has a bearing on whether punitive damages can be awarded in actions brought under the 1933 Act. As the Second Circuit pointed out in Globus, "courts have endeavored to treat the ... [1933 Act and the 1934 Act] in pari materia and to construe them as a single comprehensive scheme of regulation." Therefore, any limitation [such as § 28(a)] which applies to actions brought under one statute should also apply to those brought under the other statute. In deciding the Globus case, the Second Circuit had already held in Green that § 28(a) limited plaintiffs' recovery to actual damages and, to this extent, the Green holding was used to buttress the Globus holding. Presumably, the in pari materia argument would have produced the opposite holding in the Globus case if the Second Circuit, in deciding the Green case, had followed the approach of the Colorado District Court in the de Haas case.

Some guidance in determining whether punitive damages should be awarded in implied actions under the 1933 Act and the 1934 Act may be afforded by examining the same problem in the context of other federal statutes. In the antitrust laws, Congress specifically authorized a treble damage civil action.

Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United
with the intent that such an action, which would allow private litigants to recover damages disproportionate to their actual losses, would serve to effectuate enforcement of the antitrust laws. It has been argued that, on the basis of the treble damage provision of the antitrust laws, judgments in excess of actual damages in private actions under other federal statutes should not be permitted in the absence of express Congressional authorization. On the other hand, punitive damages have been recovered in actions brought under the express civil liability provision of the Civil Rights Act. And in the case of an implied right of action under another federal statute, it has been held that punitive damages could be recovered since, in actions sounding in tort, "punitive damages have traditionally been allowed: . . . irrespective of enabling legislation." In rejecting a comparison with other federal statutes, the Second Circuit concluded in the Globus case that the issue "is complicated by the presence of a conflicting gaggle of general rules." The Second Circuit's refusal to look at other federal statutes seems reasonable because the presence of § 28(a) in the 1934 Act may make a comparison with other federal statutes less meaningful.

III. Punitive Damage Awards under the Express Liability Provisions of the 1933 Act

While § 28(a) of the 1934 Act clearly precludes punitive damage awards in actions brought under the express liability provisions of that statute, the very absence in the 1933 Act of a provision similar to § 28(a) of the 1934 Act might indicate that actions brought under the express liability provisions of the 1933

States in which the defendant resides or is found or has an agent without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.


52 418 F.2d at 1284.
Act are not subject to the same limitation. But one of the three express civil liability provisions of the 1933 Act, § 11, which deals with misstatements in a registration statement and which contains a specific formula for ascertaining actual damages, specifically provides that under no circumstances “shall the amount recoverable under . . . [§ 11] exceed the price at which the security was offered to the public.” Such a limitation clearly precludes the award of punitive damages in a § 11 action.

Section 12(1) of the 1933 Act provides that any person who offers or sells a security in violation of § 5 of the 1933 Act is liable to the person purchasing the security from him. A plaintiff need only prove a technical violation of § 5 (such as a means of interstate commerce being used to sell a security when a registration statement covering the security was not in effect) in order to prevail in a § 12(1) action; it is not necessary to prove any misstatement in connection with the sale. Since punitive damage awards in the fraud area are at least associated with some misstatement or other fraudulent act, it would seem anomalous to permit such recovery in a § 12(1) action where, in order to recover compensatory damages, no misstatement or other fraudulent act need be shown.

Section 12(2) of the 1933 Act provides that any person who offers or sells a security by means of a prospectus or oral communication which is materially misleading shall be liable to the person purchasing the security from him. In

53 On the other hand, as the Second Circuit noted in Globus, many courts try to integrate the provisions of the 1933 Act and the 1934 Act and it can be said that § 28(a) applies not only to the express liability provisions of the 1934 Act, but to those of the 1933 Act as well, 418 F.2d at 1286.


55 Section 11(g), 15 U.S.C. § 77k(g) (1964).

56 See Shonts v. Hirlman, 28 F. Supp. 478, 482, (S.D. Cal. 1939), “[i]t is evident that the Congress intended to make the [§ 11] action, notwithstanding its origin in fraud, purely compensatory.”


Any person who—

(1) offers or sells a security in violation of section 5,

shall be liable to the person purchasing such security from him, who, may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.


Any person who—

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission shall be liable to the person purchasing such security from him, who, may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

60 Assuming the jurisdictional requirements of § 12(2) are satisfied and the defendant cannot “sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known” of the misstatement, 15 U.S.C. § 77l(2) (1964).
a § 12(2) action, the plaintiff may sue for rescission if he still owns the security or for damages if he no longer owns the security. If the plaintiff brings an action for rescission, he “recover[s] the consideration paid for such security with interest thereon.” There is no formula, however, for determining the recovery in a § 12(2) action where the plaintiff no longer owns the security, and it might be argued that punitive damages can be recovered in such a § 12(2) action. On the other hand, the recovery is specified in a § 12(2) rescission action (seemingly precluding a punitive damage award) and it would be inequitable to allow one plaintiff to recover punitive damages in a § 12(2) action for damages where he no longer owns the security and deny recovery of punitive damages in a § 12(2) action for rescission. Yet there has been an indication that punitive damages might be awarded in an action under § 12(2). In Nagel v. Prescott & Co., the U.S. District Court for the Northern District of Ohio observed that “[a]lthough there is no provision in the . . . [1933] Act authorizing recovery of punitive damages, it is clear that the plaintiffs may so recover upon a proper showing of maliciously improper conduct.” It should be noted, however, that Nagel v. Prescott & Co. arose on the defendants’ objections to certain of the plaintiffs’ interrogatories and the statement of the court regarding recovery of punitive damages was merely dictum.

If punitive damages are to be awarded at all under the federal securities acts, such awards ought to be recovered in implied actions under the 1933 Act and 1934 Act rather than an express cause of action such as § 12(2) inasmuch as the implied actions are grounded on tort law concepts and are closer to the law of torts than the express actions.

IV. Policy Considerations

The essential question is whether punitive damage awards will fit into the statutory scheme of the 1933 Act and 1934 Act and aid in the enforcement of the two statutes. Indeed, policy considerations were the real rationale of the circuit courts in the Globus and deHaas opinions. (One significant difference between the two cases is, however, that the Tenth Circuit could have opted to decide the deHaas case on the basis of § 28(a) whereas the Second Circuit had no such statutory “handle” in the Globus case.) Acknowledging that punitive damage awards would serve the functions of retribution and deterrence, the Second and Tenth Circuits noted that there already were many provisions of the 1933 Act and the 1934 Act which serve these same functions and that punitive damage awards would be unnecessarily duplicative.

61 Of course, the very absence in § 12 of a limitation similar to the one found in § 11(g) might be interpreted as indicating that punitive damages can be recovered in an action under § 12(1) or § 12(2).
63 Id. at 449 (dictum). The plaintiffs' complaint was couched in the language of § 12(2).
64 418 F.2d 1276, 1284 (2d Cir. 1969), the Second Circuit relied "on an analysis of the role punitive damages would play in the statutory scheme established for the enforcement of the . . . [1933] Act. . . . The seminal question is whether punitive damage recovery is necessary for the effective enforcement of the [1933] Act." 435 F.2d 1223, 1230 (10th Cir. 1970), the Tenth Circuit based its holding "upon an analysis of the policies underlying the [Federal] securities laws and the awarding of punitive damages."
A. Relationship to Criminal Penalties and Other Sanctions

The 1933 and 1934 Acts contain criminal penalties which provide for fines as well as imprisonment. To the extent that criminal penalties serve to punish a wrongdoer and serve to warn him and others not to commit similar heinous acts in the future, criminal penalties and punitive damages serve the same functions. In fact, the imposition of fines is closely analogous to a punitive damage award since both force erring defendants to disgorge money irrespective of a victim's loss.

While it is true that punitive damage awards would be duplicative of the criminal penalties of the 1933 Act and 1934 Act, the fact is that this is the very nature of punitive damages. For example, the act of striking another, a battery, might give rise to criminal prosecution as well as a civil action seeking punitive damages. The rationale for this seeming duplication of function is that punitive damage awards are intended to supplement the criminal sanctions.

B. Compensatory Damages As A Sufficient Deterrent

The Second and Tenth Circuits indicated that violations of the federal securities acts often harm a large number of persons and that a successful class action will have a potent deterrent effect in view of the fact that it will multiply the compensatory damages. By denying punitive damages for all purposes, however, the Second Circuit has denied them even in instances where a securities fraud has been perpetrated by a wrongdoer upon one or a few victims. In a case where the total actual damages suffered by a victim are minimal, he would be discouraged from seeking redress because of the expense of litigating his claim. In that case, the possibility of recovering punitive damages could be an effective incentive to seeking redress of the fraud perpetrated on him.

C. The Possibility of Jury Abuse

The Second Circuit indicated its concern over "huge and perhaps capricious punitive damages which some juries have awarded." It should be noted, however, that in the only two actions under the federal securities acts where the

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66 Of course, in the case of fines, the money is paid over to the state whereas punitive damage awards are a windfall to the victim.
67 The possibility of duplication didn't overly concern the trial judge in the Globus case who opined that punitive damages were in accord with the overall remedial purposes of the 1933 Act and would serve to further those purposes, 287 F. Supp. at 195. Additionally, it has been suggested that punitive damages are not intended to be a substitute for criminal penalties but as enlarged damages for a civil wrong, Great A. & P. Co. v. Smith, 281 Ky. 583, 136 S. W. 2d 759 (1939).
70 Green v. Wolf Corp., 406 F.2d 291, 303 n.18 (2d Cir. 1968).
issue of punitive damage awards was submitted for jury determination, the juries have exercised restraint. In the deHaas case, the jury awarded only $5,000 in punitive damages whereas the verdict with respect to compensatory damages was substantially more. In Globus, the jury verdict was for approximately $40,000 in punitive damages, only about $7,000 more than the compensatory damages recovered.

If a jury should assess punitive damages that are grossly excessive or capricious, the trial judge or an appellate court could, in the exercise of its judicial discretion, employ remittitur to diminish the jury verdict. Remittitur conditions an order for a new trial upon the plaintiff's failure to remit that portion of the verdict which the court deems excessive. While some courts are reluctant to employ remittitur, it is often used when the jury's verdict "shocks the court's conscience."

An additional concern is that juries will assess punitive damages against corporations and the incidence of such an award would ultimately be borne by blameless stockholders who were mere "innocent pawns." In the deHaas and Globus cases, however, the juries did not assess punitive awards against the defendant corporations even though the corporations were defendants in these cases. If a jury did assess a punitive damage award against a corporation, a court could always take advantage of remittitur to reduce or even eliminate such an award. Furthermore, the concern for blameless stockholders ultimately bearing a punitive damage award would not be applicable in the case of a 10b-5 action brought by a minority stockholder of a small closely-held corporation against the majority stockholder and such corporation.

D. The Problem of Successive Punitive Damage Awards

The Second Circuit was concerned that if all those who suffer losses by reason of a misstatement in a prospectus or offering circular bring suit and recover punitive damages in addition to compensatory damages, "the sum of the liabilities could well bankrupt an otherwise honest issuer who egregiously erred in one instance which affected many," especially where there may be successive punitive awards because it is not possible to bring all the plaintiffs into a single lawsuit. The Second Circuit also noted that it knew of no principle

72 See 418 F.2d at 1286 n.10, where the Second Circuit acknowledges the jury's restraint in Globus.
73 See F. R. Civ. P. 59. See also 6A Moore, FEDERAL PRACTICE ¶ 59.05[3] (2d ed. 1968). Cf. Faulk v. Aware, Inc. 19 App. Div. 2d 464, 467, 244 N.Y.S. 2d 259; 264-65 (1963), aff'd mem., 14 N.Y. 2d 899, 252 N.Y.S. 2d 95, 200 N.E. 2d 78 (1964), cert. denied, 380 U.S. 916 (1965), "a court may not stand by idly when it is apparent that a verdict is shockingly excessive. A jury's verdict must have some relation to reality and it is the court's duty to keep it so. But see deHaas v. Empire Petroleum Co., 435 F.2d 1223, 1231 (10th Cir. 1970), "[t]raditional judicial controls over verdicts would, in theory, prevent such an occurrence, but post-verdict procedures are but a method of admitting the existence of initial failure in the administration of justice."
75 Green v. Wolf Corp., 406 F.2d 291, 303 (2d Cir. 1968).
whereby the first punitive award exhausts all future punitive awards and that even if there was such a principle, it would be inequitable to provide the first litigant with such a windfall. The Tenth Circuit considered various procedural devices such as consolidation and class actions to prevent the “overkill,” but concluded that these “devices may not always be appropriate . . . and there is no chance of attaining a single federal forum for actions that may be brought in the state courts under [section] 17(a) . . . and for common law fraud.”

It is interesting to note that the Second Circuit cited and discussed its opinion in Roginsky v. Richardson-Merrell, Inc., in commenting on the staggering liabilities which might result if punitive damages were allowed in the situation where many persons suffered losses by reason of a misstatement. The Roginsky case presented a similar problem in a different context. A drug manufacturer was sued for an ailment the plaintiff had developed from a drug which the manufacturer had marketed. Several hundred other actions against the same manufacturer had also been instituted by persons claiming to have suffered similar injuries. In addition to compensatory damages of $17,500, the jury awarded the plaintiff $100,000 in punitive damages which the trial judge refused to eliminate or reduce. On appeal, the Second Circuit reversed the punitive damage award noting that if all potential plaintiffs were able to recover punitive damages, the aggregate amount of the recovery, when added to already large compensatory damages, could reach catastrophic amounts running into millions of dollars. Instead of denying punitive damage awards under all circumstances, as was done in the Green and Globus cases, the Second Circuit thought that “drastic judicial control of the amount of punitive awards [was necessary] so as to keep the prospective total within some manageable bounds.” Thus, a judge should carefully review the evidence before submitting the issue of punitive damages to a jury or, alternatively, there should be a “higher standard of proof for the award of punitive damages.” It is somewhat unfair, however, to compare the Second Circuit’s approach in Roginsky with that in the Green and Globus cases because the Roginsky case involved a pure tort action which has traditionally been held to support possible punitive damage awards whereas the Green and Globus cases involved the relatively novel issues of whether punitive damages can be recovered in causes of action which were based upon the federal securities acts or the rules and regulations promulgated thereunder. Unlike the Roginsky case, in the Green and Globus cases the Second Circuit was faced with problems of interpreting Congressional intent, including considerations as to whether punitive damage awards would further the statutory purposes of the federal securities acts.

V. Problems To Be Resolved

If there should be a change in the present attitude of the courts concerning

77 DeHaas v. Empire Petroleum Co., 435 F.2d 1223, 1231 (10th Cir. 1970).
78 378 F.2d 832 (2d Cir. 1967).
79 Id. at 839 and 841.
81 378 F.2d at 851.
punitive damage awards in actions brought under the 1933 Act and the 1934 Act, there would be many problems which would have to be resolved involving the mechanics of this remedy. For example, will a victim of a securities fraud who has suffered only nominal damages be able to maintain an action for punitive damages? If so, there is a real possibility of a flood of lawsuits being instituted under the 1933 Act and 1934 Act. Assuming that a showing of actual damages is necessary, must the punitive damage award bear a reasonable relationship or be in proportion to the amount of actual damages? Another problem is evidentiary but is of great significance, involving the question of whether evidence of the financial condition of one or more defendants is admissible as a proper matter for consideration in fixing punitive damages. Such evidence would enable a jury to determine how much of a punitive damage award might be necessary to punish an erring defendant, but it could work to prejudice a defendant of substantial wealth. Finally, the most important problem of all is the standard which a judge should instruct the jury to apply in determining whether punitive damages should be awarded in an action under the 1933 Act or the 1934 Act.

In other words, aside from intentional conduct which clearly ought to be the basis for a punitive damage award, will “reckless or wanton conduct” or even “grossly negligent” conduct suffice for punitive damage recovery?

In answering these questions in the context of actions under the 1933 Act and 1934 Act, the courts could choose to apply state law. This is what has been done in deciding statute of limitations questions for implied actions under the 1933 Act and 1934 Act; the courts have looked to the statute of limitations of the forum state. Generally, the rationale for choosing state law seems to be that when there is no federally enacted standard, the silence of Congress is to be interpreted as indicating a desire to adopt state rules. Occasionally, it has been suggested that actions under rule 10b-5 as well as the other implied actions are not really federal actions but state actions.
A major disadvantage in choosing state rules on the various aspects of punitive damage awards is that it permits a "plaintiff a considerable amount of forum shopping." By way of example, if a victim of a securities fraud does not have substantial compensatory damages, he will avoid bringing his action in a federal court situated in Pennsylvania if at all possible since that state requires that punitive damages must bear a reasonable relationship to actual damages and he will choose a federal court situated in a state where there is no such limitation.

There are two alternatives to choosing state law. The federal courts could look to federal common law on punitive damages, or the federal courts might fashion a substantive law of punitive damages for actions under the federal securities acts. The advantage of this approach is that there will be uniformity in this area. One disadvantage, however, is that many years (if not decades) might pass before the courts ultimately decide many of these issues.

Notwithstanding the points set forth in the Green, Globus and deHaas cases, it would appear that plaintiffs will continue aggressively to seek punitive damage awards in actions under the 1933 Act and 1934 Act. This should evoke further analysis of the policy considerations underlying such awards. It is too early to assume that these recent cases will be dispositive of the issue.

\[\text{Thus, even though the command or the moral duty is found in a federal statute or regulation, the cause of action is formulated under state law doctrines and is therefore not subject to any limitations found in the federal statute such as those of § 28(a).}\]

\[\text{89 3 Loss 1772 (2d ed. 1961).}\]


\[\text{91 By deciding that § 17(a) of the 1933 Act will not support punitive damage awards in the Globus case, the Second Circuit acknowledged that it was also avoiding "the need to decide which law of punitive damages applies—state or federal common law or perhaps federal law incorporating state law," 418 F. 2d at 1287 n. 13.}\]

\[\text{92 Cf. Textile Workers Union v. Lincoln Mills, 335 U.S. 448, 456 (1957): "[w]e conclude that the substantive law to apply in suits under § 301(a) [of the Taft-Hartley Act] is Federal law, which the courts must fashion from the policy of our national labor laws."}\]