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Richard H. Gilden

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PUNITIVE DAMAGES IN IMPLIED PRIVATE ACTIONS FOR FRAUD UNDER THE SECURITIES LAWS

The Securities Act of 1933¹ and the Securities Exchange Act of 1934² create express civil remedies for certain violations of the securities laws.³ More important in recent years, however, has been the implied right to private actions under the general anti-fraud provisions—rule 10b-5,⁴ promulgated under section 10(b) of the 1934 Act,⁵ and section 17(a) of the 1933 Act.⁶ In shaping the elements of damages available in implied anti-fraud private actions, courts are divided as to whether punitive damages should be allowed.⁷

¹ 15 U.S.C. §§ 77a-aa (1964).

² *Id.* §§ 78a-hh.

³ 1933 Act: § 11, 15 U.S.C. § 77k (1964) (false registration statement); § 12, 15 U.S.C. § 77l (1964) (false prospectus or communication with respect to a sale). 1934 Act: § 9, 15 U.S.C. § 78i (1964) (manipulation of security prices); § 16(b), 15 U.S.C. § 78p(b) (1964) (short-swing profits of insiders); § 18(a), 15 U.S.C. § 78r(a) (1964) (false or misleading document filed with the SEC). The express actions are common law actions modified by simplifying the elements of proof. A. BROMBERG, *SECURITIES LAW—FRAUD—SEC RULE 10b-5*, § 2.7(1) (1969) [hereinafter cited as BROMBERG]; 3 L. LOSS, *SECURITIES REGULATION 1430-44* (2d ed. 1961) [hereinafter cited as Loss]. See also Shulman, *Civil Liability and the Securities Act*, 43 *YALE L.J.* 227 (1933).

⁴ 17 C.F.R. § 240.10b-5 (1969). The Supreme Court refused to reject an implied private action under rule 10b-5 when the opportunity presented itself. *Suowitz v. Hilton Hotels Corp.*, 383 U.S. 363 (1966); cf. *SEC v. National Securities, Inc.*, 393 U.S. 453, 467 n.9 (1969). In addition, a private action under rule 10b-5 has been recognized by ten of eleven courts of appeals and a district court in the remaining circuit, and no court that has considered the issue has denied such an action in theory. 6 Loss 3871-73.

Approximately one-third of the cases, public and private, brought pursuant to all federal securities statutes are under rule 10b-5. BROMBERG § 2.5(6).

⁵ 15 U.S.C. § 78j (1964).

⁶ *Id.* § 77q. Notwithstanding serious doubts as to the availability of an implied private action pursuant to this section (3 Loss 1785-87), most courts that have considered the question accept a private action on the same reasoning used to imply a private action under rule 10b-5. 6 Loss 3913-15.

A third general antifraud provision, Securities Exchange Act § 15(c)(1), 15 U.S.C. § 78o(c)(1) (1964), is limited to brokers and dealers in over-the-counter transactions.

⁷ Opposing punitive damages: *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276 (2d Cir. 1969), *aff'g in part, rev'g in part* 287 F. Supp. 188 (S.D.N.Y. 1968), *cert. denied*, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970); *Baumel v. Rosen*, 412 F.2d 571 (4th Cir. 1969) (*dictum*), *cert. denied*, 90 S. Ct. 681 (1970); *Green v. Wolf Corp.*, 406 F.2d 291, 302-03 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); *Myzel v. Fields*, 386 F.2d 718, 748 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Pappas v. Moss*, 257 F. Supp. 345, 364 (D.N.J. 1966), *rev'd on other grounds*, 393 F.2d 865 (3d Cir. 1968); *Mills v. Sarjem Corp.*, 133 F. Supp. 753 (D.N.J. 1955). See also *Reynolds v. Texas Gulf Sulphur Co.*, CCH FED. SEC. L. REP. ¶ 92,494, at 98,318 (D. Utah Oct. 17, 1969); *Kohler v. Kohler Co.*, 208 F. Supp. 808, 825 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963).

Allowing punitive damages: *deHaas v. Empire Petroleum Co.*, 302 F. Supp. 647 (D. Colo. 1969); *Hecht v. Harris, Upham & Co.*, 283 F. Supp. 417, 444 (N.D. Cal. 1968) (*dic-*

I

THEORIES OF IMPLIED PRIVATE ACTIONS

None of the theories that courts have relied upon in allowing private actions for securities fraud are adequate for deciding whether punitive damages should lie in such actions. One theory is that the right to recover damages for injuries sustained through the violation of a statute "is so fundamental and so deeply ingrained in the law that where it is not expressly denied the intention to withhold it should appear very clearly and plainly."⁸ Deciding to allow an action for damages, however, does not determine the measure of damages. Punitive damages for aggravated conduct are often recoverable in a tort action for deceit,⁹ but an inference of punitive damages from the mere presence of a statutory prohibition of fraud in securities transactions seems too strained to be conclusive.¹⁰

A second theory for implying a private fraud action rests on section 29(b) of the 1934 Act,¹¹ which voids contracts made in violation of the Act. This section "almost necessarily" implies a private remedy, for "[t]he statute would be of little value unless a party to the contract could apply to the Courts to relieve himself of obligations under it or to escape its consequences."¹² This theory sounds in contract, and it seems illogical to apply it to a situation that is basically tortious. Even if the contract theory is accepted, however, it is of no aid in determining the availability of punitive damages. The general theory is that punitive damages will not be allowed in simple contract actions, but some courts have permitted punitive damages where a tortious breach is combined with a contract claim.¹³

Another approach was indicated by the Supreme Court when it

tum); *Nagel v. Prescott & Co.*, 36 F.R.D. 445, 449 (N.D. Ohio 1964) (dictum). See also *Stevens v. Abbott, Proctor & Paine*, 288 F. Supp. 836, 848 (E.D. Va. 1968).

⁸ *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946); accord, RESTATEMENT OF TORTS § 286 (1934), modified by RESTATEMENT (SECOND) OF TORTS § 286 (1965).

⁹ W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 2, at 10 (3d ed. 1964) [hereinafter cited as PROSSER].

¹⁰ See Note, *Scienter and Rule 10b-5*, 69 COLUM. L. REV. 1057, 1062-63 (1969).

¹¹ 15 U.S.C. § 78cc(b) (1964).

¹² *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946).

¹³ G. GRISMORE, PRINCIPLES OF THE LAW OF CONTRACTS § 202 (rev. ed. 1965); L. SIMPSON, THE LAW OF CONTRACTS § 195, at 394 (1965); Simpson, *Punitive Damages for Breach of Contract*, 20 OHIO ST. L.J. 284 (1959); Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517, 531-33 (1957); see *PSG Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 417 F.2d 659; 663 (9th Cir. 1969), cert. denied, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970).

approved the implication of a private remedy under section 14(a) of the 1934 Act¹⁴ in *J. I. Case Co. v. Borak*.¹⁵ The Court held that federal courts have power to effect the broad remedial purpose of Congress in establishing a comprehensive scheme of securities regulations; the existence of this power implies the ability to grant any remedy normally available to a litigant in similar cases of economic wrongdoing.¹⁶ But the broad congressional intent to regulate securities transactions is of no assistance in determining the elements of damages in an action that Congress failed to consider.¹⁷

II

POLICIES AND PUNITIVE DAMAGES

A. Availability of Punitive Damages Under the Statutory Schemes

1. The 1933 Act

There is no wording in the 1933 Act that expressly limits section 17(a) to compensatory damages.¹⁸ On the other hand, the sections of the 1933 Act that explicitly grant private remedies also explicitly limit damages.¹⁹ The absence of such a specific limitation in section 17(a) arguably evidences a congressional intent to allow punitive damages, but this argument fails because the private remedy under section 17(a) is implied by the courts; congressional intent as to the elements of damages is nonexistent.²⁰

¹⁴ 15 U.S.C. § 78n(a) (1964).

¹⁵ 377 U.S. 426 (1964). Although § 14(a) relates to proxy violations and not necessarily to fraudulent activities, the general theories supporting implication of a private action seem uniform throughout the securities acts. See *Mills v. Electric Auto-Lite Co.*, 90 S. Ct. 616, 625 (1970).

¹⁶ 377 U.S. at 433.

¹⁷ See, e.g., Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 NW. U.L. REV. 627 (1963); Comment, *Civil Remedies Available to Buyers and Sellers Under the 1933 and 1934 Federal Securities Laws*, 38 WASH. L. REV. 627, 636 (1963); Comment, *Punitive Damages Under Section 17(a) of the Securities Act: A Myopic View of Congressional Intent*, 15 WAYNE L. REV. 792, 797-98 (1969); Note, *Civil Liability Under Rule X-10b-5*, 42 VA. L. REV. 537, 542 (1956).

¹⁸ *Globus v. Law Research Serv., Inc.*, 287 F. Supp. 188, 193 (S.D.N.Y. 1968), *aff'd in part, rev'd in part*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970).

¹⁹ §§ 11(e), (g), 15 U.S.C. §§ 77k(e), (g) (1964); § 12, 15 U.S.C. § 77i (1964).

²⁰ Cf. *Sidney Wanzer & Sons, Inc. v. Milk Drivers Union, Teamsters Local 753*, 249 F. Supp. 664, 670 n.4 (N.D. Ill. 1966) (implied private action under § 301 of the Labor Management Relations Act of 1947, 29 U.S.C. § 185 (1964)):

A "Competent Congress" argument is available to each side. On the one hand, § 303 explicitly limits a plaintiff's recovery to damages "by him sustained." The argument is that, in writing § 303, Congress demonstrated that it

An argument better than one based on congressional "intent" rests on the distinction between the nature of the private remedies provided by section 17(a) and by sections 11²¹ and 12²² of the 1933 Act. Sections 11 and 12 are not essentially fraud²³ or tort²⁴ actions, and each so limits recovery as to exclude punitive damages.²⁵ The implied action under section 17(a), on the other hand, is of a different type; it is a fraud action and requires proof different from that required under sections 11 and 12.²⁶ In instances of securities violations not prohibited

knew how to limit damages when it wanted to, and that Congress's failure to do so in § 301 indicates that no such limitation was intended in § 301.

On the other hand, Congress has written explicit provisions providing for exemplary or punitive damages into numerous other statutes. E.g., the anti-trust laws . . . [and] the patent laws In writing these provisions, Congress has demonstrated that it knows how to provide for such damages when it wants to. The argument is that Congress' [sic] failure to so provide in § 301 indicates that such damages are not to be awarded under § 301. . . .

At best, this kind of point is unpersuasive makeweight. Where, as here, there are strong reasons for reading the statute one way, rather than another, I do not find it necessary to divine the intent of Congress by choosing between two credible, but conflicting, versions of the same bad argument.

See also *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946).

²¹ 15 U.S.C. § 77k (1964).

²² *Id.* § 77l.

²³ E.g., *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 786 (2d Cir. 1951) (§ 11); 3 Loss 1693 (liability under § 12(1) is "virtually absolute"); *id.* at 1700 (§ 12(2) is basically a contract action for rescission rather than a tort action for deceit).

²⁴ The difference between §§ 11 and 12 and § 17(a) private actions may be analogized to the distinction between *malum in se* and *malum prohibitum* in criminal law. *Malum in se* (§ 17) would be a crime regardless of any statutory violation due to the inherent evil of the act, but *malum prohibitum* (§§ 11 and 12) is wrongful only due to the enactment of a regulatory statute. See generally R. PERKINS, *CRIMINAL LAW* 784-98 (2d ed. 1969).

At least one commentator believes there is a distinction between §§ 11 and 12(2) and § 17(a) as to the nature of the remedy. 82 HARV. L. REV. 951, 953-54 (1969).

²⁵ Section 11(g) provides: "In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public." 48 Stat. 83 (1933), 15 U.S.C. § 77k(g) (1964). A plaintiff under § 12 may "recover the consideration paid for such security . . . less the amount of any income received thereon . . . or . . . damages if he no longer owns the security." 48 Stat. 84 (1933), 15 U.S.C. § 77i (1964).

Although some courts have alluded to the possibility of punitive damages under § 12 in cases in which plaintiff no longer holds the security for which he paid (see *Berley v. Dreyfus & Co.*, 43 F.R.D. 397, 399 (S.D.N.Y. 1967); *Nagel v. Prescott & Co.*, 36 F.R.D. 445, 449 (N.D. Ohio 1964)), it seems clear from the nature of § 12(2) that damages should be limited to the equivalent of rescission. 3 Loss 1721.

²⁶ Although many courts have instinctively implied a private action in § 17(a) in any sale situation covered by rule 10b-5 (6 Loss 3913-14), a better rule would be to allow such an action under § 17(a) only where fraud is alleged. The reasoning behind allowing mere negligent misrepresentation to form the basis of a rule 10b-5 action does not apply to the 1933 Act, which covers such conduct amply in § 11 and § 12. 3 Loss 1785; see *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 867-68 (2d Cir. 1968) (Friendly, J., concurring), *cert. denied*, 394 U.S. 976 (1969); Weiss, *Globus v. Law Research: A Case Study*, 6 ABA LAW NOTES 1, 2 (1969).

by sections 11 or 12 but within the prohibition of section 17(a), the need for an effective fraud remedy for aggravated conduct under section 17(a) may justify a recovery of punitive damages. And even though some instances of securities violations may fall within the bans of section 17(a) and either section 11 or section 12, the sections provide separate causes of action whose measures of damages are separately calculated. The recovery limitations in sections 11 and 12 have no bearing on a recovery based on a section 17(a) theory.

2. *The 1934 Act*

Unlike the 1933 Act, the Securities Exchange Act of 1934 contains an express measure of damages. Section 28(a) limits recovery "under the provisions of this chapter" to "actual damages."²⁷ Several courts and commentators argue that this section limits recovery in an implied action under rule 10b-5,²⁸ while others make the conclusory statement that "under the provisions of this chapter" refers only to actions expressly created by the Act and not to implied remedies.²⁹ The latter view seems correct, lack of analysis notwithstanding.

Sections 9³⁰ and 18(a)³¹ are intended to provide anti-fraud actions, but stringent causation tests³² in both sections and the need for willful intent in section 9 have rendered these sections impotent.³³ Recogniz-

²⁷ 15 U.S.C. § 78bb(a) (1964).

²⁸ *E.g.*, *Baumel v. Rosen*, 412 F.2d 571, 576 (4th Cir. 1969) (dictum), *cert. denied*, 90 S. Ct. 681 (1970); *Green v. Wolf Corp.*, 406 F.2d 291, 302-03 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); *Myzel v. Fields*, 386 F.2d 718, 748 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Pappas v. Moss*, 257 F. Supp. 345, 364 (D.N.J. 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); *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 769-70 (D.N.J. 1955); *BROMBERG* § 9.1, at 229; *Comment, Private Remedies Available Under Rule 10b-5*, 20 Sw. L.J. 620, 624 (1966); *Note, Remedies For Private Parties Under Rule 10b-5*, 10 B.C. IND. & COM. L. REV. 337, 338 (1969); *see Reynolds v. Texas Gulf Sulphur Co.*, CCH FED. SEC. L. REP. ¶ 92,494, at 98,318 (D. Utah Oct. 17, 1969); *Kohler v. Kohler Co.*, 208 F. Supp. 808, 825 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963); *Paul H. Aschkar & Co. v. Kamen & Co.*, 1964-66 CCH Fed. Sec. L. Rep. 95,134, 95,139 (S.D. Cal. 1964) (conclusion of law without reference to § 28(a)); 6 Loss 3781-83.

²⁹ *deHaas v. Empire Petroleum Co.*, 302 F. Supp. 647, 649 (D. Colo. 1969); *Hecht v. Harris, Upham & Co.*, 283 F. Supp. 417, 444-45 (N.D. Cal. 1968) (dictum); *Baumel v. Rosen*, 283 F. Supp. 128, 145 (D. Md. 1968) (dictum), *aff'd in part, rev'd in part*, 412 F.2d 571 (4th Cir. 1969) (punitive damages not allowed), *cert. denied*, 90 S. Ct. 681 (1970); *cf. Stevens v. Abbott, Proctor & Paine*, 288 F. Supp. 836, 848 (E.D. Va. 1968).

³⁰ 15 U.S.C. § 78i (1964) (prohibition against manipulation of security prices).

³¹ *Id.* § 78r(a) (liability for misleading statements).

³² 3 Loss 1748-49, 1752.

³³ In no case adjudicated under § 9 has plaintiff obtained a final judgment. 3 Loss 1748; *see, e.g.*, *Brittin v. Schweickart*, 1957-61 CCH Fed. Sec. L. Rep. 93,433, 93,436 (S.D.N.Y. 1961). Few actions have been brought under § 18(a), but, again, none of the plaintiffs has had success. 3 Loss 1753 n.228.

ing the need for an effective private anti-fraud provision, the courts have implied one under rule 10b-5, although neither Congress³⁴ nor the SEC³⁵ intended a private action under section 10(b) or rule 10b-5.³⁶ Because of the policies the implied action seeks to further, and because the express anti-fraud actions are ineffective, private actions under rule 10b-5 should be allowed full effectiveness, including the availability, if needed, of punitive damages. It would be as self-defeating automatically to apply the limitation of section 28(a) to the implied action as it would be to apply the causation tests of sections 9 and 18(a).³⁷

B. Policies Supporting Punitive Damages Under Section 17(a) and Rule 10b-5

Punishment is usually not a function of the civil law,³⁸ but "[w]here the defendant's wrongdoing has been intentional and deliberate, and has the character of outrage frequently associated with crime, all but a few courts have permitted the jury to award in the tort action 'punitive' or 'exemplary' damages . . ."³⁹ Punitive damages serve the purposes of both individual and general deterrence and of retribution.⁴⁰ Because they are more than compensatory, these damages encourage individuals to bring private actions where public officials

³⁴ See Ruder, *supra* note 17.

³⁵ The drafters of the rule had no idea that it would be used as the basis for private litigation. *Conference on Codification of the Federal Securities Law*, 22 BUS. LAW. 793, 922 (1967).

³⁶ The functions of both § 9 (*see* United States v. Lilley, 291 F. Supp. 989, 993 (S.D. Tex. 1968)) and § 18 (*e.g.*, Fischer v. Kletz, 266 F. Supp. 180, 189-94 (S.D.N.Y. 1967); Miller v. Bargain City, U.S.A., Inc., 229 F. Supp. 33, 36-37 (E.D. Pa. 1964)) have been absorbed by rule 10b-5.

³⁷ Section 16(b) is unproductive in this analysis. This section is similar to § 11 and § 12 of the 1933 Act in that it explicitly allows a private non-fraud action. *See, e.g.*, Marquette Cement Mfg. Co. v. Andreas, 239 F. Supp. 962, 965-66 (S.D.N.Y. 1965). Damages—recoverable only from certain insiders and only by the issuer (or derivatively by its stockholders)—are limited to "short-swing" profits. Section 28(a) is irrelevant, except to prohibit double recovery, due to this self-contained limitation.

In some cases in which insiders are liable under § 16(b), they may also be liable under rule 10b-5 to individual plaintiffs. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

³⁸ *E.g.*, PROSSER § 2, at 9; Friedman, *Delay as a Bar to Rescission*, 26 CORNELL L.Q. 426, 447 (1941): "It may be said that one guilty of fraud is entitled to no undue consideration from the court. Yet the policy of the law on its civil side is not punishment." (footnote omitted).

³⁹ PROSSER § 2, at 9 (footnote omitted); *see* Note, *supra* note 13.

⁴⁰ PROSSER § 2, at 9; Note, *The Imposition of Punishment by Civil Courts: A Reappraisal of Punitive Damages*, 41 N.Y.U.L. REV. 1158, 1161-63 (1966); Note, *Criminal Safeguards and the Punitive Damages Defendant*, 34 U. CHI. L. REV. 408 n.1 (1967); *see* Note, *supra* note 13, at 521-22.

cannot effectively regulate the field,⁴¹ or where the penalties of the law are not enforced or enforceable.⁴²

Punitive damages have been implied into other federal statutes, such as a civil rights statute,⁴³ an admiralty statute,⁴⁴ and the Civil Aeronautics Act,⁴⁵ in situations in which a need for such recovery was demonstrated. In labor law the weight of authority is against allowing punitive damages,⁴⁶ and this fact has been cited as evidence of a divi-

⁴¹ See PROSSER § 2, at 11. Private enforcement of the securities laws is necessary due to the limited resources of the SEC. *E.g.*, Bernfeld, *Class Actions and Federal Securities Laws*, 55 CORNELL L. REV. 78 (1969); Loomis, *The S.E.C. Looks at BarChris*, 24 BUS. LAW. 693, 694 (1969).

⁴² See generally Note, *The Imposition of Punishment by Civil Courts: A Reappraisal of Punitive Damages*, 41 N.Y.U.L. REV. 1158 (1966). This criterion seems applicable to the securities laws. See note 55 and accompanying text *infra*.

⁴³ *Mansell v. Saunders*, 372 F.2d 573, 576 (5th Cir. 1967), and *Basista v. Weir*, 340 F.2d 74, 87-88 (3d Cir. 1965), read punitive damages into the Civil Rights Act of 1871, 42 U.S.C. § 1983 (1964).

⁴⁴ *In re Den Norske Amerikalinje A/S*, 276 F. Supp. 163 (N.D. Ohio 1967), *rev'd sub nom.* *United States Steel Corp. v. Fuhrman*, 407 F.2d 1143 (6th Cir. 1969), *petition for cert. filed*, 37 U.S.L.W. 3452 (U.S. May 16, 1969) (No. 1403, 1968 term; renumbered No. 124, 1969 term), held the master of a ship and his corporate employer liable for punitive damages under the Jones Act, 46 U.S.C. § 688 (1964), when grievously poor seamanship was shown. The court of appeals reversed as to the corporate employer, but stated that punitive damages would be available in a proper case. The absence of a provision for punitive damages in either the Jones Act or the Federal Employers' Liability Act, 45 U.S.C. §§ 51-60 (1964), to which the Jones Act refers, did not disturb the court:

Exemplary damages are the product of the common law and are not a creature of legislation. Thus, while certain statutes may specifically authorize the recovery of punitive damages, such specific reference is neither common nor necessary. 276 F. Supp. at 176.

The Supreme Court and several courts of appeals have denied liability without proof of fault under the Jones Act, but in a recent case a court allowed plaintiff to amend his complaint to allege punitive damages. The court reasoned that if plaintiff could prove *aggravated* fault, recovery for punitive damages was not inconsistent with these prior holdings or congressional intent. *Gunnip v. Warner Co.*, 43 F.R.D. 365 (E.D. Pa. 1968).

⁴⁵ The availability of punitive damages has been implied into § 404(b) of the Civil Aeronautics Act of 1938, 49 U.S.C. § 1374(b) (1964). In *Wills v. TWA*, 200 F. Supp. 360 (S.D. Cal. 1961), plaintiff was delayed due to the overbooking of a flight on which he had a confirmed reservation. In allowing punitive damages, the court analogized to the Civil Rights Act and attempted to vindicate the rights of all passengers and protect against future abuses. *Id.* at 367. The function of punitive damages under this Act could be compared with the function of punitive damages under the securities laws:

[T]he purpose of the award is two-fold, to complement the criminal and injunctive provisions of the Act, and to afford the courts the means to make effective vindication of the rights of the individual airline passenger which have been willfully or wantonly violated.

Id. at 368.

⁴⁶ *E.g.*, *Local 20, Teamsters v. Morton*, 377 U.S. 252 (1964) (§ 303(a) of the Labor Management Relations Act of 1947, 29 U.S.C. § 187 (1964)); *Magelssen v. Local 518, Plasterers and Cement Masons*, 240 F. Supp. 259 (W.D. Mo. 1965) (§ 101(a)(5) of the Landrum-Griffin Act of 1959, 29 U.S.C. § 411 (1964)); *Burris v. International Bhd. of*

sion on the question whether punitive damages should be implied into federal statutes.⁴⁷ There is, however, a "peculiar interdependency of labor and management in the modern industrial complex."⁴⁸ The purpose of the labor laws is to promote industrial peace, and punishing an offender with punitive damages seems counterproductive.⁴⁹ The parties to a securities fraud action are not similarly interdependent, and the securities laws serve functions different from those served by the labor laws. Their policies may, on balance, favor punitive damages.⁵⁰

Teamsters, 224 F. Supp. 277 (W.D.N.C. 1963) (§ 101(a)(5) of the Landrum-Griffin Act of 1959, 29 U.S.C. § 411 (1964)); Comment, *Monetary Recovery Under the Federal Labor Statutes*, 45 TEXAS L. REV. 881, 902-03 (1967). *Contra, e.g.*, Local 127, *United Shoe Workers of America v. Brooks Shoe Mfg. Co.*, 298 F.2d 277 (3d Cir. 1962) (§ 301(a) of the Labor Management Relations Act of 1947, 29 U.S.C. § 185(a) (1964)); *Farowitz v. Musicians Local 802*, 241 F. Supp. 895 (S.D.N.Y. 1965) (§ 101(a)(2) of the Landrum-Griffin Act of 1959, 29 U.S.C. § 411 (1964)).

The implied private action under § 301(a) of the LMRA offers some analogy to implied private actions under the securities laws. The Supreme Court in *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448 (1957), envisaged broad judicial action in forming remedies. This was to be done with an eye toward the purposes of the statute, and "[t]he range of judicial inventiveness will be determined by the nature of the problem." *Id.* at 457. Compare *J.I. Case Co. v. Borak*, 377 U.S. 426, 433 (1964).

⁴⁷ *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1284 (2d Cir. 1969), *cert. denied*, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970).

⁴⁸ Note, *Labor Law: Runaway Shop: Compensatory and Punitive Damages under L.M.R.A. Sections 301 and 302*, 47 CORNELL L.Q. 112, 117 (1961).

⁴⁹ *Brandwen, Punitive-Exemplary Damages in Labor Relations Litigation*, 29 U. CHI. L. REV. 460 (1962). "[T]he doctrine [of punitive damages] will only exacerbate labor-management relations and threaten stability in our society. There may still be an adequate residuum of admonition in compensatory damages to serve the legitimate aims of tort liability." *Id.* at 482. But it is unclear whether the "remedial" nature of the labor laws necessarily excludes punitive damages if such damages have an individual rather than a general deterrence effect: "imposition of sanctions which exceed what is necessary to pacify the particular labor-management irritation before the court are not permitted." *Sidney Wanzer & Sons, Inc. v. Milk Drivers Union, Teamsters Local 753*, 249 F. Supp. 664, 670 (N.D. Ill. 1966) (emphasis added). Punitive damages, therefore, might be assessed in extraordinary labor relations cases. *Id.* at 671.

⁵⁰ Congress's purpose in passing § 17(a) was undoubtedly to establish a general anti-fraud provision more effective than a common law fraud action in securities transactions. See § Loss 1423-24. Rule 10b-5 was enacted merely to extend the effect of § 17(a) to aid sellers of securities as well as buyers. See SEC Securities Exchange Act Release No. 3230 (May 21, 1942):

The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase.

See also *Conference on Codification of the Federal Securities Laws*, *supra* note 35, at 922. The rule was enacted after a proposal to achieve the same result by legislative action was unsuccessfully made in Congress. § Loss 1426-27.

Attempts to differentiate the policies supporting punitive damages under these two provisions seem unfounded. See, e.g., Comment, *Fashioning a Lid for Pandora's Box: A Legitimate Role for Rule 10b-5 in Private Actions Against Insider Trading on a National*

Arguments can be made that express provisions of the securities acts adequately achieve the goals of retribution and deterrence.⁵¹ Both fines and imprisonment are provided for by the acts.⁵² Criminal prosecutions under rule 10b-5, however, "have not been particularly extensive or significant,"⁵³ and, in situations where fraudulent activities could be highly profitable, the deterrent effect of fines seems minimal.⁵⁴ Further, the "psychological deterrent" connected to a conviction for a "white collar crime" is a relatively unknown factor.⁵⁵

A second potential deterrent against securities fraud is the threat of suspension of registrations, suspension of trading, or expulsion from a national securities exchange for violations of the 1934 Act.⁵⁶ But the

Stock Exchange, 16 U.C.L.A.L. REV. 404, 420 (1969); Note, *Securities Regulation—Punitive Damages Appropriate in Civil Action Based on Section 17(a) of the Securities Act of 1933*, 54 VA. L. REV. 1560, 1568 (1968).

⁵¹ *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1285 (2d Cir. 1969), cert. denied, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970); see Note, *supra* note 50, at 1570-71.

⁵² The 1933 Act provides for a maximum fine of \$5,000 and/or five years in prison for willful violations of the provisions of the Act or willful misstatements or omissions of material facts in a registration statement. 15 U.S.C. § 77x (1964). Any person who willfully and knowingly violates the anti-fraud provisions of the 1934 Act is subject to a maximum fine of \$10,000 and/or two years in prison, but no person may be imprisoned "if he proves that he had no knowledge of such rule or regulation." *Id.* § 78ff(a).

For a discussion of the interrelationship of punitive damages and criminal safeguards, see Note, *Criminal Safeguards and the Punitive Damages Defendant*, 34 U. CHI. L. REV. 408 (1967).

⁵³ BROMBERG § 10.3. For a list of the reported cases see 3 Loss 1449 n.15. Although such actions have "some deterrent effect," exact statistics are unavailable. BROMBERG § 10.3.

⁵⁴ Comment, *supra* note 50, at 411.

⁵⁵ Much "white collar crime" probably goes undetected, and studies and statistics on such crimes are sketchy. It seems, however, that there is much more public sympathy for corporate violators than for common criminals. PRESIDENT'S COMM'N ON LAW ENFORCEMENT AND ADMINISTRATION OF JUSTICE, REPORT: THE CHALLENGE OF CRIME IN A FREE SOCIETY 48 (1967).

Another factor in the weakness of deterrence is the failure to prosecute. In an analogous situation, a district court reviewed defendant's correspondence regarding his plan to violate the antitrust laws. His letters outlined the benefits to be received by the conspiracy and weighed them against the chances of being prosecuted:

He passes lightly over the likelihood of a criminal prosecution—the only language, perhaps, that he could understand. His judgment in this regard has proved to be correct. This court has not been apprised of the reason for failure of criminal prosecution. This unanswered question rests on the doorstep of the Department of Justice.

United States v. Hartford-Empire Co., 46 F. Supp. 541, 606 (N.D. Ohio 1942).

The difficult evidentiary problems in a criminal securities fraud case (see SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, pt. 1, at 307-08 (1963)) seem to enhance the deterrent effect of punitive damages in a civil case, in which the burden of proof is lighter.

⁵⁶ 15 U.S.C. §§ 78o(b)(5)-(7), 78s(a) (1964). There are no comparable provisions in the 1933 Act.

effect of these remedies is not as far-ranging as it may seem,⁵⁷ and such rapidly developing fields as insider liability⁵⁸ under rule 10b-5 are entirely excluded.⁵⁹

The sheer size of purely compensatory recoveries may also have a significant deterrent effect. This contention, however, ignores one of the goals of punitive damages in such cases. If recovery is limited to plaintiff's "actual damages," even if profits made by defendant at plaintiff's expense are included,⁶⁰ it still may be profitable for defendant to violate the law, since there is little chance of being discovered in every fraudulent act.⁶¹ Although the likelihood of apprehension remains constant, allowance of punitive damages would ensure that no possibility of profit is left open to a wrongdoer caught in a blatantly fraudulent scheme.

Perhaps the most forceful argument against the need for punitive damages rests on the liberalization of the class action under the revised federal rule of civil procedure 23.⁶² Prior to the 1966 revision, effective

⁵⁷ The section that applies to stocks traded on a national exchange personally affects only members or officers of the exchange (*id.* § 78s(a)(3)); the provision that covers over-the-counter securities only allows punishment of broker-dealers and their associates (*id.* § 78o(b)(5)).

⁵⁸ See, e.g., *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

⁵⁹ The inadequacy of these remedies is "the primary reason" motivating the SEC to encourage private actions under rule 10b-5. Comment, *supra* note 50, at 411.

⁶⁰ Recovery of profits made by defendant is not always granted. See *Estate Counseling Serv., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527 (10th Cir. 1962) (applying the "out-of-pocket" measure of damages); Note, *Measurement of Damages in Private Actions Under Rule 10b-5*, 1968 WASH. U.L.Q. 165, 175.

⁶¹ See Comment, *supra* note 50, at 417; *cf.* *United States v. Hartford-Empire Co.*, 46 F. Supp. 541 (N.D. Ohio 1942):

In analyzing the likelihood of civil prosecution at some time in the distant future, . . . [the antitrust violator] coldly weighs the consequences on the one side, together with the penalties that might be exacted, and the ultimate financial gains on the other side. Then . . . he decides to do it and risk the whipping.

Id. at 606.

⁶² See generally BROMBERG § 11.6; 6 LOSS 3938-70; Bernfeld, *supra* note 41; Comment, *Adequate Representation, Notice and the New Class Action Rule: Effectuating Remedies Provided by the Securities Laws*, 116 U. PA. L. REV. 889 (1968); Note, *Class Action Treatment of Securities Fraud Suits Under the Revised Rule 23*, 36 GEO. WASH. L. REV. 1150 (1968). See also Note, *Securities Regulation—Class Actions—Common Questions of Misrepresentation Predominate Over Individual Questions of Reliance—Punitive Damages Are Not Recoverable Under the Securities Exchange Act of 1934*, 44 NOTRE DAME LAW. 984-90 (1969).

The Advisory Committee on the Federal Rules stated that a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action, and it may remain so despite the need, if liability is found, for separate determination of the damages suffered by individuals within the class.

Advisory Committee's Note to Rule 23(b)(3), 39 F.R.D. 98, 103 (1966).

use of the class action was often impossible in securities fraud cases⁶³ in which many small claims arose from the same fraudulent conduct. Liberalization has made the class action a more attractive device in securities fraud cases.⁶⁴ Thus, in light of the new rule, the argument that punitive damages are especially needed where private parties cannot afford to prosecute their small claims⁶⁵ seems to lose its impact. This is not entirely true, however, since most of "[t]he principal questions that were litigated . . . under the old rule survive in varying degrees,"⁶⁶ and new procedural requirements partially limit the effectiveness of the class action.⁶⁷ Furthermore, a class action would be dismissed in a securities fraud case if there were materially different statements or omissions or a significant variance in reliance.⁶⁸ In any event, a class action and punitive damages need not be mutually exclusive. The proportion of punitive damages to be awarded each member of the class may be determined in separate proceedings when the division of the actual damages is made.⁶⁹

Although the express statutory scheme does not adequately deter or punish, the question remains whether awarding punitive damages in securities fraud litigation raises unwarranted problems and injustices. Fears have been expressed that because of the numerous persons affected by a securities fraud jury will award huge recoveries;⁷⁰ an issuer or underwriter could possibly be bankrupted by one wrong.⁷¹ This ignores the court's control over the amount of a jury's award of

⁶³ Under the prior rule a class action in a securities fraud case included only members of the class who were parties to the action or intervenors before the court. Bernfeld, *supra* note 41, at 78 n.5. See also *Green v. Wolf Corp.*, 406 F.2d 291, 297-98 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); 6 Loss 3940-41; Comment, *supra* note 62, at 890-93; Note, *Class Action Treatment of Securities Fraud Suits Under the Revised Rule 23*, 36 GEO. WASH. L. REV. 1150, 1150-51 (1968).

⁶⁴ The judgment in a class action under the new rule is now binding on all members of the class unless they request exclusion. FED. R. CIV. P. 23(c)(3).

⁶⁵ See PROSSER § 2, at 11.

⁶⁶ 6 Loss 3944.

⁶⁷ Comment, *supra* note 62, at 893. The notice provisions present especially "formidable" problems. Bernfeld, *supra* note 41, at 86.

⁶⁸ *Berger v. Purolator Prods., Inc.*, 41 F.R.D. 542 (S.D.N.Y. 1966).

⁶⁹ See Advisory Committee's Note, *supra* note 62, at 103. Punitive damages may be an incentive for members of the class to come forward and claim their share of the award.

⁷⁰ *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1285 (2d Cir. 1969), *cert. denied*, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970).

⁷¹ *Id.*; cf. Note, *Insiders' Liability Under Rule 10b-5 for the Illegal Purchase of Actively Traded Securities*, 78 YALE L.J. 864, 891 (1969). But see Comment, *supra* note 50, at 417-20. Fears of complex problems as to punitive recoveries may be ill-founded, for "[m]ost 10b-5 private actions have involved securities of small, closely held corporations traded in face-to-face transactions." *Id.* at 406.

punitive damages.⁷² Also, in determining punitive damages the jury is allowed to consider defendant's wealth⁷³ and other personal criteria.⁷⁴

Further problems with punitive damages in securities fraud cases may arise if actions are brought in more than one court. The courts may be unable to coordinate their activities in order to control the size of damages awards, and the need for punitive damages may be eliminated after the first few recoveries, so that later plaintiffs may be deprived of the benefits of a punitive damages "windfall."⁷⁵ These difficulties, however, will not arise in the typical implied private anti-fraud action, which involves the "securities of small, closely held corporations traded in face-to-face transactions."⁷⁶ And in the extraordinary case involving a huge transaction, the actions, under proper circumstances, may be transferred for consolidation;⁷⁷ alternatively, a

⁷² Reduction of a punitive damages award by appellate courts is not uncommon in New York. See cases cited in *Roginsky v. Richardson-Merrell, Inc.*, 378 F.2d 832, 840 n.12 (2d Cir. 1967). Arguments have been made in favor of increasing the judge's power of review over the size of the jury's award of punitive damages. Note, *supra* note 13, at 529-31.

⁷³ PROSSER § 2, at 14; Note, *supra* note 13, at 528.

⁷⁴ Punitive damages allow "additional flexibility for admonition, so that the punishment may be roughly adjusted to the offender." Note, *supra* note 13, at 524.

⁷⁵ *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1285-86 (2d Cir. 1969), cert. denied, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970); see 82 HARV. L. REV. 951, 957 (1969).

⁷⁶ Comment, *supra* note 50, at 406; see *Loomis, Enforcement Problems Under the Federal Securities Laws*, 14 BUS. LAW. 665, 672-73 (1959).

⁷⁷ All actions under rule 10b-5 must be brought in federal district courts; actions under § 17(a), however, may be brought in federal or state courts. 15 U.S.C. §§ 77v, 78aa (1964). Federal district courts are empowered, in their discretion, to transfer any civil action to any other district in which it might have been brought, when this change will serve the convenience of the parties and the goal of justice. 28 U.S.C. § 1404(a) (1964). See generally *Abbott Laboratories v. Gardner*, 387 U.S. 136, 154-55 (1967); F. JAMES, CIVIL PROCEDURE § 12.18 (1965); *Judicial Economy: Fairness and Convenience of Place of Trial: Long-Arm Jurisdiction in District Courts*, 47 F.R.D. 73, 105-06 (1969). A district court recently employed this device to consolidate a 10b-5 action brought in several districts. *Wolf v. Ackerman*, CCH FED. SEC. L. REP. ¶ 92,525 (S.D.N.Y. Nov. 20, 1969). A total amount of punitive damages can be decided upon in a central district (e.g., where the fraud took place, the principal place of business of the issuer, or the place of the exchange where the purchase or sale occurred) and an escrow fund established from which plaintiffs who prove their injuries may claim a share within a specified period of time. See *SEC v. Golconda Mining Co.*, BNA SEC. REG. & L. REP. A-14, No. 24, Nov. 12, 1969 (S.D.N.Y. Oct. 31, 1969) (defendant ordered to pay insider's profits to trustee to satisfy judgment); BNA SEC. REG. & L. REP. A-7, No. 19, Oct. 8, 1969 (SEC proposes that insiders' profits be returned to corporation of defrauded stockholders to be placed in interest-bearing fund out of which judgments will be paid); Note, *A Suggested Locus of Recovery in National Exchange Violations of Rule 10b-5*, 54 CORNELL L. REV. 306, 313 (1969) (security fraud indemnity fund proposed).

There is concurrent jurisdiction in state and federal courts for actions under § 17(a), but removal of an action from a state to a federal court is currently unavailable for actions

stay may be granted pending the outcome of the action first initiated.⁷⁸

Arguably, punitive damages, at least against publicly held corporations, are undesirable "because the heavy burden would ultimately fall on all the stockholders, including mere innocent pawn." ⁷⁹ Of course, this argument is inapplicable to the closely held corporation typically involved in an implied private anti-fraud action;⁸⁰ the stockholders certainly have control over the corporate agents or concerned brokers. Despite occasional injury to some innocent stockholders, it may be more beneficial to allow punitive damages in an effort to deter securities frauds.⁸¹

A plaintiff's remedies in private actions under section 17(a) and rule 10b-5 are potent, but there are areas where additional punitive and deterrent devices are needed.⁸² Under proper procedures, punitive

brought under the 1933 Act. A recent ALI proposal would allow such removal. ALI STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS 77-78, 183 (1969).

Lack of congressional intent also causes problems in this area of implied remedies. See Loss, *The SEC Proxy Rules and State Law*, 73 HARV. L. REV. 1249 (1960):

Those who worked on the act most likely gave no thought to the problem of finding a single forum for a private action . . . , because there is no reason to believe that they "intended" any actions under section 14 in the ordinary sense.

Id. at 1275 (emphasis in the original).

⁷⁸ *Abbott Laboratories v. Gardner*, 387 U.S. 136, 155 (1967).

⁷⁹ *Green v. Wolf Corp.*, 406 F.2d 291, 303 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

⁸⁰ See Comment, *supra* note 50, at 406.

⁸¹ [T]here may be good reason to use whatever devices are available to deter owners and managing officers from tolerating misconduct by employees. If exemplary damages will encourage employers to exercise closer control over their servants, there is sufficient ground for awarding them.

Note, *supra* note 13, at 526; see C. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 80, at 283-84 (1935); PROSSER § 2, at 12.

⁸² Under the doctrine of pendent jurisdiction, a federal court may accept jurisdiction over a case involving both federal and state claims if both claims arose from the same set of operative facts, even though the federal claim is later dismissed. See *UMW v. Gibbs*, 383 U.S. 715, 721-28 (1966). See also Note, *UMW v. Gibbs and Pendent Jurisdiction*, 81 HARV. L. REV. 657, 668-69 (1968). Thus plaintiff in a securities fraud case may assert a state common law claim in fraud as well as a federal claim under the Securities Act of 1933 or the Securities Exchange Act of 1934 in federal district court. *Jung v. K. & D. Mining Co.*, 260 F.2d 607 (7th Cir. 1958). But see *Local 20, Teamsters v. Morton*, 377 U.S. 252, 257-60 (1964) (federal preemption may preclude state claim). Plaintiff, therefore, might recover punitive damages on a state common law fraud count in a 10b-5 private action. *Gann v. Bernzomatic Corp.*, 262 F. Supp. 301, 304 (S.D.N.Y. 1966); Note, *supra* note 60, at 168 n.20. See generally *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970); Lowenfels, *Pendent Jurisdiction and the Federal Securities Acts*, 67 COLUM. L. REV. 475 (1967); Note, *The Evolution and Scope of the Doctrine of Pendent Jurisdiction in the Federal Courts*, 62 COLUM. L. REV. 1018 (1962); Annot., 5 A.L.R.3d 1040 (1966).

The ALI has proposed enacting the doctrine into federal statutory law (ALI, *supra* note 77, at ix, 210-12), and Professor Loss would have the courts use their discretion in assuming pendent jurisdiction over a count allowing punitive damages if a dichotomy

damages awarded after an aggravated tort would serve a necessary function as an extraordinary remedy.⁸³

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were to arise between § 17(a) and rule 10b-5 with respect to this type of remedy. 6 Loss 3783.

⁸³ "If exemplary damages *are* ever permissible under either act, presumably the criteria for their award are substantially the same as at common law." 6 Loss 3782 (emphasis in the original). Proof of a specific intent to deceive is not necessary to show a violation of § 17(a) or rule 10b-5. *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1291 (2d Cir. 1969), *cert. denied*, 38 U.S.L.W. 3320 (U.S. Feb. 24, 1970); see Note, *Scienter in Private Damage Actions Under Rule 10b-5*, 57 GEO. L.J. 1108, 1109 (1969). However, a court should demand proof of such an intent before it awards punitive damages. This ensures that such an award is granted only in cases of clearly abusive conduct. *deHaas v. Empire Petroleum Co.*, 302 F. Supp. 647, 649 (D. Colo. 1969); see Note, *supra*, at 1115. Federal courts should apply federal common law criteria for punitive damages rather than the multitude of tests that exist in the various states. 82 HARV. L. REV. 951, 956 (1969). *Contra*, Note, *Securities Regulation—Indemnification Agreement Between Underwriter and Issuer Held Unenforceable as Against Public Policy and Award of Punitive Damages Allowed*, 44 N.Y.U.L. REV. 226, 234 (1969). Four states deny punitive damages altogether. PROSSER § 2, at 9 n.60. For a compilation of state damages standards, see *Basista v. Weir*, 340 F.2d 74, 86 n.11 (3d Cir. 1965). The need for uniformity of treatment arises from the federal nature of the remedy and the nature of the securities laws. See generally *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).