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Broadening Actual Damages in the Context of the Commodities Exchange Act

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BROADENING ACTUAL DAMAGES IN THE CONTEXT OF THE COMMODITIES EXCHANGE ACT

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INTRODUCTION

Futures trading can result in both large gains on a relatively small investment as well as similarly large losses on the same investment.[1] The Commodities Exchange Act[2] (the "CEA" or the "Act") was enacted to regulate the futures markets.[3] The CEA provides for a private right of action against brokers, exchanges and related organizations that have manipulated the commodities futures markets in violation of the Act.[4] The extent of actual damages under the Act, however, remains uncertain.[5]

Although the CEA, as originally enacted, was silent about private rights of action,[6] many courts found them to be implied.[7] In

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[1] NAT'L FUTURES ASS'N, OPPORTUNITY AND RISK: AN EDUCATIONAL GUIDE TO TRADING FUTURES AND OPTIONS ON FUTURES 5 (2006).

[2] Commodities Exchange Act, 7 U.S.C. §§ 1–27(f) (2007).

[3] The CEA was enacted as "a comprehensive regulatory structure to oversee the volatile and esoteric futures trading complex." H.R. REP. NO. 93-975, at 1 (1974).

[4] 7 U.S.C. § 25(b).

[5] *In re* Cannon, 230 B.R. 546, 594 (W.D. Tenn. 1999), *rev'd on other grounds*; Stevenson v. J.C. Bradford & Co., 2000 U.S. Dist. LEXIS 22634 (W.D. Tenn. Mar. 31, 2000); Apex Oil Co. v. DiMauro, 744 F. Supp. 53, 58 (S.D.N.Y. 1990); Minpeco v. Conticommodity Services, Inc., 676 F. Supp. 486, 494–95 (S.D.N.Y. 1987).

[6] Curran v. Merrill Lynch, Pierce, Fenner & Smith, 622 F.2d 216, 230

1982, the Supreme Court held that purchasers of futures contracts that were subject to improper manipulation in violation of the CEA could maintain a private right of action against dealers, brokers and exchanges.[8] Within a year, Congress ratified this holding by enacting Section 22 of the CEA, which provided for an explicit private right of action and recovery of "actual damages" for victorious plaintiffs.[9]

Notwithstanding that private right of action, what "actual damages" are within the context of futures trading manipulation and the CEA remains unclear.[10] Actual damages is a common legal remedy that has been construed narrowly in some areas of law[11] and broadly in others.[12] Generally, actual damages are considered synonymous with compensatory damages.[13] The Supreme Court, in *Affiliated Ute Citizens v. United States*,[14] found actual damages to

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(6th Cir. 1980).

[7] *Id*.

[8] Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353, 394 (1982).

[9] 7 U.S.C. § 25(a)(1).

[10] *Cannon*, 230 B.R. at 594.

[11] *See* Mack v. Johnson, 430 F. Supp. 1139, 1149 (E.D. Pa. 1977) (defining actual damages in a civil rights suit as "including out-of-pocket, or pecuniary losses, as well as compensation for physical and mental suffering"); Wilson v. Prasse, 325 F. Supp. 9, 15 (W.D. Pa. 1971) (defining actual damages in another civil rights suit as "expenses for which plaintiff was out of pocket for food purchased from the commissary and also for humiliation, embarrassment and mental suffering").

[12] *See* United States v. State Road Dept. of Fla., 189 F.2d 591, 596 (5th Cir. 1951) (finding, in a situation where a bridge was damaged by boats in a storm, that the requirement of the statute of "actual damages to the highway by reason of his wrongful act" included more than "the cost of repairing and restoring;" it included consequential damages as well); On Davis v. The Gap, Inc., 246 F.3d 152, 164 (2d Cir. 2001) (proposing that in copyright law a broad construction of actual damages is appropriate).

[13] BLACK'S LAW DICTIONARY 170 (Bryan A. Garner ed., 2nd pocket ed. 2001). Compensatory damages are "damages, measured by the harm suffered, awarded to the injured person as due compensation." Dictionary.com, http://dictionary.reference.com/browse/compensatory damages (last visited Sept. 28, 2007).

[14] 406 U.S. 128 (1972).

be "the difference between the fair value of all that the [plaintiff] received and the fair value of what he would have received had there been no fraudulent conduct."[15]

This definition of actual damages is problematic because it provides little incentive for individuals with a small economic injury to pursue private rights of action, and as a result, this limited incentive to private litigants renders the private right of action less effective as a device to bring miscreants to justice for their manipulations. This problem manifests itself in situations where, because of the nature of the futures markets, a manipulator realizes and retains a significant windfall without a mechanism for disgorgement.[16] Such a result can occur because particular investors may not bring suit;[17] these investors either do not know they have been defrauded or the high cost of litigation would not justify the damages they could be awarded if they initiated proceedings. In such cases, the Commodity Futures Trading Commission ("CFTC") may bring suit in district court against the manipulator on behalf of the market participants.[18] However, if the CFTC fails to bring suit, a market manipulator may retain a significant portion of prior gains. Further, if damages are restricted to a measurement

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[15] *Id.* at 155; *see also* Strobl v. N.Y. Mercantile Exch., 582 F. Supp. 770, 779 (S.D.N.Y. 1984).

[16] *E.g.,* Commodities Futures Trading Comm'n v. Heffernan, 274 F. Supp. 2d 1375, 1377 n.1 (S.D. Ga. 2003) (no particular investor was victimized but the defendant managed to defraud his way into $275,000). The private right of action under the CEA does not provide a mechanism for disgorgement. 7 U.S.C. § 25(b) (2007).

[17] 7 U.S.C. § 25(b) (2007).

[18] An example can be seen in *Heffernan*, where the CFTC brought an action against Heffernan for CEA violations without alleging victimization of any particular investor. *Heffernan*, 274 F. Supp. 2d at 1377 n.1. There the court used its broad equitable powers to issue a remedy of disgorgement. *Id. See also* Sec. Exch. Comm'n v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978). Thus, the *Heffernan* case illustrates that when a particular investor suffers injury because of some form of market misconduct and files suit, the defrauding party could have profited more than any one particular investor lost. 7 U.S.C.A. § 13a-1 (1999); *Heffernan*, 274 F. Supp. 2d at 1377 n.1. *See also* Lawton v. Nyman, 327 F.3d 30 (1st Cir. 2003); Estate of Pidcock v. Sunnyland America, 726 F. Supp. 1322 (S.D. Ga. 1989).

of the loss the plaintiff suffered, but the defendant's profit from the fraudulent transaction is greater than that loss, the defendant will still benefit from the fraudulent conduct despite the judgment against him.[19]

This perverse result leads to a more disturbing policy concern: the CEA, which was designed to deter manipulative practices in the futures markets, could be used to protect defendants from, rather than subject defendants to, significant liability, provided potential plaintiff loss levels are kept below potential defendant profit margins.[20] To prevent this contradictory result, and to enhance the deterrent and remedial effect of the private right of action, actual damages within the meaning of the CEA should be clarified to reach beyond strict compensatory damages.

This Note interprets the meaning of actual damages in the context of the CEA. Part I briefly reviews the general meaning of actual damages. Part II summarizes the history and functions of the CEA and the commodity futures markets. Part III presents arguments in favor of a flexible interpretation of actual damages based on the legislative history of the Act, the nature of futures markets, the similarities between commodities and securities law that suggest similar interpretations of the term are appropriate, the interpretation of actual damages in the context of the similarly worded Securities Exchange Act ("SEA") and a look at other areas of law that have used actual damages as a measure of recovery and have addressed similar policy concerns to those presented in this Note. Part IV proposes two solutions, both of which require a flexible interpretation of actual damages, to the situation posed in

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[19] *See*, *e.g.*, *Heffernan*, 274 F. Supp. 2d at 1377 n.1; Commodities Futures Trading Comm'n v. Muller, 570 F.2d 1296 (5th Cir. 1978); Lawton v. Nyman, 357 F. Supp. 2d 428, 440–44 (D.R.I. 2005); City of San Jose v. Paine, Webber, Jackson & Curtis Inc., 1991 U.S. Dist. LEXIS 8318 (N.D. Cal. June 6, 1991); Commodities Futures Trading Comm'n v. Hunt, 591 F.2d 1211 (7th Cir. 1979); *Pidcock*, 726 F. Supp. at 1334–38.

[20] *See* Randall v. Loftsgaarden, 478 U.S. 647 (1986) (using similar reasoning to reach the same conclusion in the securities context with regards to the interpretation of actual damages in § 28(a) of the Securities Exchange Act; there limiting the plaintiff's recovery to actual damages would have allowed the defendant to retain money obtained through illegal conduct).

this Note where a defendant stands to profit from his fraudulent conduct. Finally, Part V concludes that a more flexible interpretation of actual damages is appropriate.

I. ACTUAL DAMAGES GENERALLY

For private recovery under the Act, a plaintiff must prove that the defendant's fraudulent conduct was one of four types of transactions covered by the statute and that the injury was caused by at least one of those transactions.[21] This was illustrated in *Ping He v. NonFerrous Metals Inc.*,[22] where the plaintiff's otherwise valid CEA claims were dismissed because he failed to prove that the defendant's conduct caused him to suffer "actual damages."[23]

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[21] 7 U.S.C. § 25(a)(1) provides as follows:

> [a]ny person . . . violates this chapter or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any person-
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> (A) who received trading advice from such person for a fee;
>
> (B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property . . . in connection with any order to make such contract;
>
> (C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of-
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> (i) an option subject to section 6c of this title . . . ;
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> (ii) a contract subject to section 23 of this title; or
>
> (iii) an interest or participation in a commodity pool; or
>
> (D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

[22] 22 F. Supp. 2d 94 (S.D.N.Y. 1998).

[23] *Id.* at 108. The Court dismissed a valid § 4b claim that NonFerrous Metals was an unregistered Futures Commodities Manager ("FCM") because Ping He failed to prove that investing with an unregistered FCM resulted in his alleged injury. *Id.*

The court wrote, "there is no legal justification for permitting private litigants to recover damages unless they can show that they were personally harmed by the defendant's violation, in the amount of damages sought."[24]

Even if a plaintiff proves that an alleged violation directly resulted in the injury, the components and extent of those damages must still be identified. Black's Law Dictionary defines actual damages as "[a]n amount awarded to a complainant to compensate for a proven injury or loss; damages that repay actual losses."[25] In most cases, actual damages will be interpreted to mean compensatory damages,[26] out-of-pocket loss or some variation on those concepts; nonetheless, actual damages can, and have been construed differently.[27] For instance, some courts have found that actual damages can include emotional and mental distress,[28] although others have declined to hold the same.[29]

Even today, the meaning of actual damages is unclear.[30] The Supreme Court in *Randall v. Loftsgaarden*,[31] tempered its holding

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[24] *Id*.

[25] BLACK'S LAW DICTIONARY 170 (Bryan A. Garner ed., 2nd pocket ed. 2001).

[26] *See, e.g.*, Chesapeake & Potomac Tel. Co. v. Clay, 194 F.2d 888 (D.C. Cir. 1952); United States v. State Road Dept. of Fla., 189 F.2d 591 (5th Cir. 1951); *see also* BLACK'S LAW DICTIONARY 170 (Bryan A. Garner ed., 2nd pocket ed. 2001).

[27] *See In re* Der, 113 B.R. 218, 231 (Bankr. D. Md. 1989) (citing Randall v. Loftsgaarden, 478 U.S. 647, 662 (1986)) (supporting a "rescissory" measure of recovery); *see also* Siebel v. Scott, 725 F.2d 995, 1001 (5th Cir. 1984); Lawton v. Nyman, 357 F. Supp. 2d 428, 442 (D.R.I. 2005).

[28] *See*, *e.g.*, Wilson v. Prasse, 325 F. Supp. 9, 15 (W.D. Pa. 1971) (characterizing actual damages as "out of pocket" loss that included monetary loss and compensation for "humiliation, embarrassment and mental suffering."); *see also* Mack v. Johnson, 430 F. Supp. 1139, 1149 (E.D. Pa. 1977) (distinguishing actual damages from nominal, punitive or exemplary damages); *see generally* Fleet Mortgage Group, Inc. v. Kaneb, 196 F.3d 265 (1st Cir. 1999); Malandris v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 447 F. Supp. 543 (D. Colo. 1977).

[29] *See* Emmons v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 532 F. Supp. 480, 485 (S.D. Ohio 1982).

[30] *In re* Cannon, 230 B.R. 546, 594 (W.D. Tenn. 1999).

[31] 478 U.S. 647 (1986).

in *Affiliated Ute Citizens*,[32] finding that the measure for actual damages "ordinarily . . . 'is the difference between the fair value of all that the [plaintiff] received and the fair value of what he would have received had there been no fraudulent conduct.'"[33] The Court's use of the term 'ordinarily' implies that in certain situations a different meaning of actual damages will be appropriate. Some courts have used the traditional interpretation of actual damages based on the facts, despite acknowledging the *Loftsgaarden* rationale,[34] while other courts have employed a more expansive approach.[35]

Given the various circumstances under which courts have been willing to expand the meaning of actual damages beyond that found in Black's Law Dictionary, it may be wise to incorporate the *Loftsgaarden* rationale by applying a fact specific approach to interpreting the actual damages language in the CEA.

II. THE COMMODITIES EXCHANGES AND THE HISTORY OF REGULATION

The public generally has little knowledge of the workings and behaviors of commodity futures. That "lack of comprehension," combined with significant growth of the markets over time, has worked "to hamper effective regulation and create an atmosphere ripe for fraud."[36] In order to understand how actual damages should be interpreted in light of the CEA, it is helpful to examine the history of the commodity futures markets, as well as the reasoning

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[32] Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972) (holding actual damages to be "the difference between the fair value of all that the [plaintiff] received and the fair value of what he would have received had there been no fraudulent conduct.").

[33] *Loftsgaarden*, 478 U.S. at 662 (quoting *Affiliated Ute Citizens*, 406 U.S. at 155).

[34] Apex Oil Co. v. DiMauro, 744 F. Supp. 53 (S.D.N.Y. 1990); Minpeco v. Conticommodity Services, Inc., 676 F. Supp. 486, 494–95 (S.D.N.Y. 1987).

[35] *Cannon*, 230 B.R. at 594–95 (awarding gross trading losses rather than the standard net economic loss based on the *Loftsgaarden* rationale).

[36] S. REP. NO. 97-495, at 1 (1982).

and goals behind their regulation.

A commodity[37] futures contract is a type of forward contract in which parties agree to buy or sell a specific quantity and quality of goods at a specified future date.[38] There are two types of futures contracts: long and short.[39] "The person who has sold a futures contract, i.e., someone committed to deliver the commodity in the future, is said to be in a 'short' position. Conversely, someone committed to accept delivery is 'long.'"[40]

Consequently, for those investors not interested in the actual commodities, their number of short contracts must equal their long contracts.[41] After discussing this nature of the commodity trading

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[37] Within the meaning of the CEA, a commodity has grown over time to encompass a wider array of goods. Early on, few goods were traded as commodities, mainly agricultural products such as "eggs, butter vegetables and grain." S. REP. NO. 97-495, at 1. Later, as the markets grew, other agricultural products, such as cotton, began being traded on exchanges, mainly Chicago and New York. *Id.* at 2–3. The 1968 amendments to the CEA added "livestock, livestock products, and frozen concentrated orange juice" to the list of traded commodities. *Id.* at 3. Up until the 1972 amendments trading was mainly in physical commodities such as "agricultural products and commercial metals." H.R. REP. 97-565, pt. 2, at 5 (1982). The Maine Potato was the commodity at issue in the *Curran* case. Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353, 355 (1982). Silver was the commodity at issue in another case. Strax v. Commodity Exchange, Inc., 524 F. Supp. 936, 938 (S.D.N.Y. 1981).

However, as the markets grew over time, the coverage of the CEA grew beyond physical commodities, securities and other financial instruments began being traded as futures. H.R. REP. 97-565, pt. 2, at 5. In the late 1970s, the Commodity Futures Trading Commission approved other financial instruments such as stock index futures and leverage contracts for trade. S. REP. NO. 97-495, at 49. The 1974 amendments expanded CEA coverage to include "all . . . goods and articles . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." *Curran*, 456 U.S. at 366 n.29.

[38] Leist v. Simplot, 638 F.2d 283, 286 (2d Cir. 1980).

[39] *Id*.

[40] *Id*.

[41] "Money is made or lost in the price different [sic] between the original contract and the offsetting transaction." *Id.* Because of this nature of the futures markets, "[a] person seeking to liquidate his futures position must form an opposite contract for the same quantity, so that his obligations under the two contracts will offset each other." *Id*.

market, Judge Henry Friendly of the United States Court of Appeals, Second Circuit observed that "[f]utures trading is a zero-sum game. Since money is made from the change in futures contract prices, and every contract has a long and a short,[42] every gain can be matched with a corresponding loss."[43]

Generally, there are two types of investors that participate in the futures markets; the Commodity Futures Trading Commission (CFTC) classified them as "hedgers" and "speculators."[44] Hedgers are usually dealers of the actual commodities who seek to lessen the risk associated with price movements whereas speculators seek to profit from the same price movements.[45]

Most buyers and sellers are speculators and do not deal in the actual commodities involved in the futures contracts.[46] Instead, these speculators try to profit from price fluctuations by liquidating their contracts prior to the date specified for the delivery of the commodity.[47] Speculators make or lose money based on the price difference between their long and short

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[42] *Id*.

[43] *Leist*, 638 F.2d 286–87.

[44] COMMODITY FUTURES TRADING COMMISSION, REPORT TO THE CONGRESS IN RESPONSE TO SECTION 21 OF THE COMMODITY EXCHANGE ACT, 96th Congress, 2d session ch. II, at 6 (1981).

> Typically, a hedger is engaged in the production, distribution, processing or consumption of the actual commodity or its byproducts. In a representative situation, the hedger holding an inventory of the physical commodity may establish an offsetting short position in the corresponding futures markets. In contrast, the speculator does not endeavor to reduce the price risk of a cash market position but rather to profit by anticipating the price movement of a commodity in which a futures position has been established. In effect, the speculator assumes the risk of price movements that the hedger seeks to avoid.

Id.

[45] *Id*.

[46] *Id*. *See also* NAT'L FUTURES ASS'N, OPPORTUNITY AND RISK: AN EDUCATIONAL GUIDE TO TRADING FUTURES AND OPTIONS ON FUTURES 4 (2006).

[47] *Leist*, 638 F.2d at 286. Speculators, essentially, bet that prices of a particular commodity will either rise or fall and they make money by guessing correctly. *Id*.

contracts.[48]

In the early days of the futures markets, this speculative activity of buying and selling futures contracts with no intention of dealing in the goods was viewed as a form of legalized gambling.[49] Despite that stigma, speculators play an essential role in the market because they absorb risk from hedgers[50] and create more trading volume and liquidity in the market, enabling hedgers and other investors to trade in large contracts.[51]

Hedgers also play an important role in the futures markets. Hedgers transfer their business risks to speculators by engaging in either short or long contracts to offset the contracts they have already made in connection with their businesses, thereby mitigating the effects of price fluctuations in their particular commodity.[52] For example, if a hedger is a corn farmer, in order to protect against falling prices in the corn market and thus declining value of his corn, he will buy offsetting futures contracts for corn,

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[48] *Id*.

[49] Michael S. Sackheim, *Parameters of Express Private Rights of Action for Violations of the Commodity Exchange Act*, 28 ST. LOUIS U. L.J. 51, 54 (1984).

[50] *Leist*, 638 F.2d at 287. "A 'hedger' is a trader with an interest in the cash market for the commodity, who deals in futures contracts as a means of transferring risks he faces in the cash market." *Id*.

[51] H.R. REP. NO. 93-975, at 138 (1974); *see also* David T. Johnston, *Understanding the Dynamics of Commodity Trading: A Success Story*, 35 BUS. LAW 705, 709 (1980) ("As a general rule, for a market to be broad enough to be efficient and to accommodate the extremely large orders that come in from time to time from dealers and commercial firms, 50 to 75 percent of the open interest and volume of trading must come from speculators—this is essential for there to be a viable market.").

[52] *Leist*, 638 F.2d at 287–88. Judge Friendly summed up this principle nicely:

> The owner of a commodity can hedge against declining prices by entering into equivalent short futures contracts for the month when he expects to be able to sell, and a processor (e. g., a miller) can hedge against increasing prices by going long for the month when he will need the commodity. Losses caused by a decline in prices on the cash market in the former case or an advance in the latter will be offset by profits in the futures transactions.

Id.

essentially betting that the price of corn will fall. As a result, if the price of corn falls, he will lose money on his crop but his futures investment will make money, thus minimizing the effects of the price fluctuation.[53]

Consumers benefit as well from the hedging function of the markets because by mitigating the risk of price fluctuations and thus the risk of doing business, a merchant can more safely operate his business on a lower profit margin without fear of business failure due to a drop in the price of his commodity.[54] As a result, he can charge lower prices to distributors who in turn can charge lower prices to consumers.[55]

Regulation of the futures markets has long been the subject of legislative debate.[56] The original Commodities Exchange Act was enacted in 1936.[57] The Act built upon previous regulatory legislation[58] by expanding its coverage to more commodities[59] and attempt[ing] to curb excessive speculation by the large market operator."[60] The goal of enacting the CEA was "to insure fair practice and honest dealing on the commodity exchanges and to provide a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of

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[53] However, the converse also must be true; if the price of corn rises, the hedger's crop will increase in value but he will simultaneously lose money on his futures investment.

[54] H.R. REP. NO. 93-975, at 132–33.

[55] *Id*.

[56] *See* Sackheim, *supra* note 49, at 51–63.

[57] Commodities Exchange Act, ch. 545, 49 Stat. 1491 (1936) (codified as amended at 7 U.S.C. §§ 1-26 (1982)).

[58] *See Leist*, 638 F.2d at 293. The Futures Trading Act of 1921 and The Grain Futures Act of 1922 were predecessors to the CEA, the first of which was declared unconstitutional. The former as an impermissible use of the taxing power in *Hill v. Wallace*, 259 U.S. 44 (1922) and the latter was a valid use of the commerce power decided in *Board of Trade v. Olsen*, 262 U.S. 1 (1923). *Leist*, 638 F.2d at 293.

[59] Wendy Collins Perdue, *Manipulation of Futures Markets: Redefining the Offense*, 56 FORDHAM L. REV. 345, 353 (1987).

[60] S. REP. NO. 97-495, at 3 (1982). The act accomplished this by "authoriz[ing] the prosecution of price manipulation as a criminal offense" and "extend[ing] to the previously uncovered field of commodity brokerage." *Id*.

producers and consumers and the exchanges themselves."[61]

The CEA was amended to increase the level of regulation[62] in 1968[63] and again in 1974.[64] During the time between the 1968 amendments and the 1974 amendments, the economy changed so that the futures markets started having a greater effect on the prices of commodities.[65] Fraud was on the rise mainly because of the lack of regulation and the emergence of new financial futures instruments that were not covered by the CEA.[66] The 1974 Amendments created the Commodity Futures Trading Commission ("CFTC") to provide further regulation to the industry and solve the concerns that had arisen since the 1968 amendments.[67] This organization was modeled after the Securities Exchange Commission ("SEC") and was deemed necessary to bridge the "regulatory gap" that existed in the area of commodity futures trading.[68]

In 1982, the CEA was amended once again to expressly reflect the recognition of a private right of action under the Act.[69] The

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[61] H.R. REP. NO. 74-421, at 1 (1935).

[62] S. REP. NO. 97-495, at 3 ("Futures Commission Merchants (FCM) were required to meet specific minimum financial standards, penalties were increased for certain violations, and the issuance of cease and desist orders was authorized. These amendments required contract markets to enforce their trading rules and contract terms . . . .").

[63] *Id*.

[64] 88 Stat. 1389 (1974) (codified as amended at 7 U.S.C. §§ 1-26 (1982)).

[65] S. REP. NO. 97-495, at 3. The government used to mitigate price fluctuations in actual consumer goods by holding stockpiles of goods and releasing them at times when prices rose rapidly, thus creating more supply, which, in turn, kept prices down. The government stockpiles soon ran out and the fluctuations in the prices in the commodity futures markets began to have a greater effect on consumer commodity prices and the producers themselves. *Id.* at 3–4.

[66] *Id*. For a detailed discussion of leverage transactions and fraudulent "Boiler Room" scandals, *see* S. REP. NO. 97-495, at 4–16.

[67] Leist v. Simplot, 638 F.2d 283, 295–96 (2d Cir. 1980) (further noting that the provisions for fraud and trading limits that came from the 1968 Amendments were largely unchanged); *see also* Sackheim, *supra* note 49, at 58–60.

[68] Sackheim, *supra* note 49, at 59 n.49.

[69] 7 U.S.C. § 25(a)(1) (2000).

Supreme Court acknowledged this right in its decision in *Merrill Lynch, Pierce, Fenner & Smith v. Curran*.[70] The Senate concluded that a private right of action was necessary for efficient resolution of claims under the CEA to avoid a "proceeding in the Reparations Section of the CFTC."[71] Before the *Curran* decision, a plaintiff seeking recompense for a loss would have to go through the CFTC—"a process which is often erratic, overburdened and rarely effective."[72]

One commentator has remarked that "[t]he passage of the 1982 Act represented what has been referred to as a 'comprehensive' legislative overhauling of the federal regulatory scheme for the futures industry and related industries."[73] Each amendment to the CEA has increased regulatory power over the futures markets, increased the breadth and force of penalties and brought more commodities under the purview of the Act.[74] Thus, the interpretation of actual damages under the CEA "must be considered against this background of increasingly strong regulation designed to insure the existence of fair and orderly markets."[75]

III. A BROAD DEFINITION OF ACTUAL DAMAGES UNDER THE CEA SHOULD BE ADOPTED IN CERTAIN CIRCUMSTANCES

Actual damages should be defined broadly enough that the threat of liability would work to prevent inequity and to further the purposes of the CEA. In most situations, actual damages should continue to be restricted to out-of-pocket loss. However, in other situations, particularly where a defendant stands to profit from his fraudulent and manipulative conduct, courts should be able and willing to apply remedies of disgorgement or rescission.

This section provides arguments to support this formulation.

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[70] Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353, 394 (1982) (recognizing an implied private right of action under the CEA).

[71] *Id*.

[72] *Id*.

[73] Sackheim, *supra* note 49, at 63 (citations omitted).

[74] Leist v. Simplot, 638 F.2d 283, 296 (2d Cir. 1980).

[75] *Id*.

Part A highlights support in the legislative history of the CEA. Part B shows that the growing and changing nature of commodity futures markets necessitates a greater measure of deterrence to manipulators and that a flexible interpretation of actual damages can accomplish that goal. Part C demonstrates that, in light of the growing similarities between commodities and securities trading, the CEA provisions for damages should be interpreted similarly to the analogous provisions under the SEA. Part D shows that the principle enunciated in *Loftsgaarden*—that it is better for victims of misconduct to benefit rather than the perpetrators and similarly, allowing the perpetrators to benefit from their misconduct would only encourage more misconduct—is neither novel nor unique to securities law and should be applied to the commodities realm. Finally, Part E addresses why a flexible measure of damages is appropriate in light of the CFTC's ability to compel manipulators to disgorge their ill-gotten profits.[76]

A. Legislative Support for a Flexible Interpretation of Actual Damages

An examination of the legislative history of the often-amended CEA supports the propositions that actual damages should not be strictly interpreted and that in certain situations flexibility in damage awards is appropriate.[77]

Reckless speculation and manipulative trading practices led to the need for congressional regulation.[78] Congress recognized the importance of the hedgers and speculators and has endeavored to preserve their functions through their scheme of regulation.[79]

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[76] *See* Commodities Futures Trading Comm'n v. Heffernan, 274 F. Supp. 2d 1375 (S.D. Ga. 2003); Commodities Futures Trading Comm'n v. Muller, 570 F.2d 1296 (5th Cir. 1978).

[77] *See generally* S. REP. NO. 97-495 (1982); H.R. REP. NO. 97-565, pt. 2 (1982); H.R. REP. NO. 74-421 (1934); H.R. REP. NO. 93-975 (1974); H.R. CONF. REP. NO. 97-964 (1982).

[78] S. REP. NO. 97-495, at 2.

[79] The CFTC was given the "responsibility of ensuring that the futures markets fulfill their historic functions of providing opportunities for hedging against future price fluctuations in commodities and mechanisms for locking in

Congress was compelled to walk a thin line between deterring excessive speculation and keeping a significant volume of speculators involved in the market.[80]

Thus, throughout the legislative history of the CEA, two competing interests have influenced Congressional decision-making: (1) providing for a fair and safe market place by deterring manipulation and fraudulent behavior,[81] and (2) preserving the hedging function of the markets that was deemed essential for the protection of the actual producers and buyers of commodities.[82] The proper interpretation of actual damages within the context of the CEA should seek to satisfy these two competing interests.

1. A History of Deterrence

Deterrence of manipulative activities has always been a driving force behind efforts at regulation since the 1800's when "[s]peculative excesses, irresponsible trading and lack of effective market regulation eventually stirred farm resentment and led to a movement . . . to abolish futures trading."[83] As markets grew and began to encompass more commodities,[84] the need for deterrence grew as well.[85] Congress responded by consistently amending the Act.[86] Through its amendments, Congress has steadily increased the breadth of statutory coverage, strengthened the powers of

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commodity prices at future dates." H.R. REP. NO. 97-565, pt. 2, at 5.

[80] The goals of enacting the CEA were "to insure fair practice and honest dealing on the commodity exchanges and to provide a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves." H.R. REP. NO. 74-421, at 1.

[81] S. REP. NO. 97-495, at 2; Donald Campbell, *Trading in Futures Under the Commodity Exchange Act*, 26 GEO. WASH. L. REV. 215, 223 (1958); *see also* H.R. REP. NO. 74-421, at 1, *supra* note 80 and accompanying text.

[82] H.R. REP. NO. 97-565, pt. 2, at 5.

[83] S. REP. NO. 97-495, at 2.

[84] Leist v. Simplot, 638 F.2d 283, 295–96 (2d Cir. 1980).

[85] *Id*.; S. REP. NO. 97-495, at 1–4.

[86] *Leist*, 638 F.2d at 296.

regulation and heightened the penalties pursuant to the Act.[87] The trend of increased and strengthened regulation suggests that the goal of deterring manipulative behavior was becoming more important.

Congress's decisions over time to increase penalties under the CEA mirrored the perceived need for deterrence. While punitive damages are not provided for under either the CEA[88] or federal securities anti-fraud laws,[89] the CEA does provide for criminal sanctions.[90] In 1936, provisions[91] for criminal offenses were extended to cover the newly enacted provisions of the amendment as well as market and price manipulation.[92] These were essentially limited to misdemeanors resulting in fines and imprisonment.[93]

These limitations did not persist.[94] In the 1968 Amendments, Congress elevated criminal price manipulation to a felony offense and increased the corresponding maximum prison sentence five-fold.[95] Just six years later, Congress increased the maximum fine associated with the penalty provisions ten-fold.[96] Section 13(a) of the CEA provides for accomplice liability so that willfully or knowingly aiding in a violation of the CEA may subject a person to

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[87] *Id*.

[88] *See* 7 U.S.C. § 25 (2000).

[89] *See* Sackheim, *supra* note 49, at 80 n.185.

[90] S. REP. NO. 97-495, at 3 ("The [1936] amendments authorized the prosecution of price manipulation as a criminal offense.").

[91] *See Leist*, 638 F.2d at 293–94. Similar provisions, invoking similar penalties, were encompassed in the CEA predecessors—The Futures Trading Act of 1921 and The Grain Futures Act of 1922. *Id.*

[92] *Id*. at 295.

[93] *Id.* at 293–94 (the penalties were essentially a carry over from the original Futures Trading Act and provided for "a fine of up to $10,000 and/or imprisonment for up to one year."); *see also* 49 Stat. 1491, 1501 (1936) (amended by 82 Stat. 26, 33 (1968)).

[94] *Leist,* 638 F.2d at 295.

[95] *Id*. In particular, embezzlement and price manipulation became felony offenses carrying greater prison sentences than they previously did as misdemeanors. The maximum sentence went up from one year to five years. 82 Stat. 26, 33–34 (1968).

[96] *Leist,* 638 F.2d at 295 (fines increased from a maximum of $10,000 to $100,000).

prosecution as a principal.[97] This section of the Act substantially mirrors federal criminal statutes for aiding and abetting.[98] Congress's ascension from misdemeanor penalties to felony offenses,[99] together with the ability to prosecute for willful conduct of someone who is not a principal,[100] has demonstrated a significant and growing interest in deterrence.

2. Preserving Hedging

Preservation of the ability of the futures markets to continue to provide an opportunity for hedging is an equally weighty interest that must not be undermined by policies aimed at deterring market and price manipulation.[101] Further, the participation of speculators in the markets is essential to ensure that the hedging function of the markets is maintained.[102] Thus, to serve both Congressional interests, the legislature must carefully craft policies that deter manipulation but that do not deter speculation.

3. A Flexible Interpretation of Actual Damages Accomplishes both Legislative Goals

Allowing flexibility in the interpretation of actual damages is a particularly effective method of deterring manipulation while retaining the participation of speculators in the market. Permitting courts to either give the defendant's windfall to a plaintiff or otherwise strip the defendant of his profits would prevent unjust enrichment in cases where the defendant stands to benefit from his wrongdoing. The prospect of the loss of all of the malefactor's illegal gain would deter similar manipulative conduct. Therefore, if potential wrongdoers were contemplating violating one of the CEA

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[97] 7 U.S.C. § 13(c)(a) (1982).

[98] Sackheim, *supra* note 49, at 87.

[99] *Leist*, 638 F.2d at 295.

[100] 7 U.S.C. § 13(c)(a) (1982).

[101] H.R. REP. NO. 97-565, pt. 2, at 5–6 (1982).

[102] H.R. REP. NO. 93-975, at 138 (1974); *see also* Johnston, *supra* note 51, at 709.

provisions, they would have to consider the full extent of the greater risks associated with being caught.

Furthermore, this approach is consistent with the purposes of the CEA because it would not have a deterrent effect on speculators.[103] By definition, honest speculators would never be reached by this penalty because they do not intend to violate the CEA. In fact, a flexible interpretation of actual damages could potentially, work to encourage speculative investors to put money into the markets because it would work to better ensure a fair and orderly functioning of the markets.

Accordingly, a flexible interpretation of actual damages would not be contrary to the legislative concerns surrounding the CEA and would, in all likelihood, further the goal of "insur[ing] fair practice and honest dealing on the commodity exchanges and [providing] a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves."[104]

B. The Nature and Size of the Futures Markets Necessitate a Flexible Interpretation of Actual Damages

As markets grow and expand their coverage to more diverse types of futures contracts,[105] they create an "atmosphere ripe for fraud"[106] because investor comprehension may lag behind the shenanigans practiced by dishonest market predators.[107] As one court put it, "[t]he methods and techniques of manipulation are

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[103] The purposes of the CEA are: (1) providing for a fair and safe market place by deterring manipulation and fraudulent behavior and (2) preserving the hedging function of the markets that was deemed essential for the protection of the actual producers and buyers of commodities. *See* S. REP. NO. 97-495 at 2 (1982); Campbell, *supra* note 81, at 223; H.R. REP. NO. 97-565, pt. 2, at 5–6.

[104] Campbell, *supra* note 81, at 223.

[105] S. REP. NO. 97-495, at 1–4.

[106] In the words of the Senate Committee on Governmental Affairs, "[t]his lack of comprehension has tended to hamper effective regulation and create an atmosphere ripe for fraud." *Id.* at 1.

[107] *Id*.

limited only by the ingenuity of man."[108]

If every gain, regardless of whether it was ill gotten, attaches to a corresponding loss, it necessarily follows that, in situations where a manipulator's gains exceed the plaintiff's loss, the manipulator will improperly receive the money of another investor who likely does not realize that he has suffered a loss as a result of the manipulator's conduct.[109] In short, the violator of the CEA would conceivably be allowed to keep money earned from his manipulative conduct that should rightfully be returned to another investor or many other investors who may not even realize that they have been defrauded.

This idea is reinforced by the fact that futures markets have been characterized as "the country's largest gambling dens,"[110] and that they often appeal to those with gambling dispositions.[111] Accordingly, one might postulate that speculators who are investing with this mindset are expecting to lose money on some or even most investments. While it is inevitable that many of these "gambling" investors will lose on some of their investments, these speculators may not be aware or concerned that any particular loss came from the illegal conduct of another person.[112]

Further, their losses would necessarily benefit another market participant by virtue of the "zero sum" nature of the markets.[113] If those losses were the result of an illegal market manipulation, and if at least a portion of every loss ends up in the hands of the manipulator, it becomes evident how a manipulator of the markets

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[108] Cargill, Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971).

[109] Leist v. Simplot, 638 F.2d 283, 286–87 (2d Cir. 1980). The "zero sum" language means that for every transaction "every gain can be matched with a corresponding loss." *Id.*

[110] Sackheim, *supra* note 49, at 54.

[111] Sackheim, *supra* note 49, at 54.

[112] Such investors may not realize there is anything they can do to recoup losses because they think that losses are just part of routine market operation or investors may realize their options but conclude that the loss was so insignificant that it was is not worth trying to recover their losses in court. In either event, these investors are not concerned about recovering their losses; they will not bring actions and the lost funds will not be sought after.

[113] *Leist*, 638 F.2d at 286–87.

could benefit from his wrongdoing. The situation is akin to a thief taking a small sum of money from everyone he knows in the hope that none of his victims will realize the theft. Most victims would not realize that they were missing any money, and even if a victim were to realize his loss, he may determine that the relatively small loss is not worth the time and resources needed to recover it. Nonetheless, the fact that no one objected to the thefts does not exonerate the thief. Similarly, it seems perverse to let a violator of the CEA keep money that was, in whole or in part, fraudulently obtained from an honest market participant. Rather, the defendant's ill-gotten profits should be disgorged or rescinded through a more flexible interpretation of actual damages under the CEA.

C. The Parallel Language in the SEA and CEA Suggest a Parallel Interpretation of Actual Damages is Proper

The bodies of law addressed by the SEA and the CEA—securities law and commodities law, respectively—are closely related[114] and have comparable provisions relating to fraud.[115] In particular, the damages provisions under § 22(c) of the CEA and § 28(a) of the SEA are similarly worded.[116] This has led many courts to use securities law cases, such as *Loftsgaarden*, to guide them in interpreting the damages provisions under the CEA.[117] Because of

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[114] *Id.* at 298 n.14 (drawing an analogy between securities law and commodities law); *see also id.* at 301 n.17 ("[T]he cases under the CEA, numerous and consistent as they are, cannot be taken in isolation but must be considered along with the vast body of law under the securities statutes which set the tone during the late '40's, the '50's, the '60's, and the early '70's, and on which the CEA decisions relied.").

[115] *See* Sackheim, *supra* note 49, at 82 (noting similarity between § 4b of the CEA to antifraud provisions of the SEA, § 10(b) and Rule 10b-5).

[116] In an effort to determine the meaning of actual damages under the CEA, Judge G. Harvey Boswell sitting in the United States Bankruptcy Court for the Western District of Tennessee, Western Division noted that "[b]ecause CEA § 22(c)tracks [sic] the language of section 28(a) of the Securities Exchange Act of 1934 . . . cases dealing with securities fraud provide direction." *In re* Cannon, 230 B.R. 546, 594 n.71 (W.D. Tenn. 1999).

[117] *See id.* at 594; Apex Oil Co. v. DiMauro, 744 F. Supp. 53, 55

their similarities, the congruence of their purposes, and the overlap of the two markets, an interpretation of actual damages under the CEA should be made in light of the decisions interpreting the same language under the SEA.

The similarities between the SEA and CEA are well recognized by courts, commentators and legislators.[118] Judge Friendly's expression of the similarities in purpose and legislative approach to the laws promulgated under the CEA and SEA is particularly clear:

> While there are differences between the commodities and securities fields, what is relevant to the present question is the common legislative objective of insuring fair dealing for investors on what are important public markets, and the common legislative approach to attaining this objective. The analogy between the two fields has been repeatedly recognized by Congress. (citations omitted). The 1936 amendments [to the CEA] arose from an explicit concern to make protection in the commodities field as strong as it was in the securities field, lest the unscrupulous would simply transfer this [sic] operations from one market to another.[119]

Though the focus of Judge Friendly's opinion was implied private rights of action under the CEA,[120] the analogy drawn between the commodities and securities fields is equally applicable to the interpretation of actual damages—the remedy prescribed by both the CEA and SEA for the same private rights of action that Judge

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(S.D.N.Y. 1990); Minpeco v. Conticommodity Services, Inc., 676 F. Supp. 486, 490 (S.D.N.Y. 1987).

[118] *See* Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353, 389 n.88 (1982) (wording of § 4(b) of the CEA and § 10(b) of SEA is similar); *Leist*, 638 F.2d at 298 n.14 ("The analogy between the two [commodities and securities] fields has been repeatedly recognized by congress.") (citations omitted); *Cannon*, 230 B.R. at 594 n.71 (recognizing analogous wording in damages provisions of the SEA and CEA); H.R. REP. 97-565, pt. 2, at 6–7 (1982) (noting the jurisdictional overlaps between the SEC and CFTC); Sackheim, *supra* note 49, at 82 (noting similarity between § 4b of CEA to antifraud provisions of the SEA, § 10(b) and Rule 10b-5; also noting same standard of proof applied in SEC and CFTC administrative enforcement proceedings).

[119] *Leist*, 638 F.2d at 298 n.14 (citations omitted).

[120] *Id.* at 285.

Friendly discussed in *Leist*.[121]

Judge Friendly's analogy, based on legislative findings,[122] is reinforced by the fact that developments in commodities law have often paralleled earlier developments in securities law.[123] Examples include the recognition of a private right of action[124] under the respective legislations and the development of similar regulatory commissions.[125]

After the enactment of the CEA, futures trading evolved to encompass more than just agricultural commodities and natural resources and began to include trading of financial instruments and indices of corporate securities.[126] Naturally, the reach of the SEA and the CEA, and the scope of their respective regulatory commissions, the SEC and the CFTC, began to overlap.[127] Congress, in the House Reports accompanying the 1982 amendments to the CEA, recognized this overlap and tellingly suggested a similar policy approach with regards to the respective regulatory bodies under the CEA and SEA: "If the CFTC is to regulate whole new types of contracts, contracts which will include securities now the responsibility of the SEC, thus drawing the two markets closer together, prudent public policy dictates that the rules governing the trading and marketing of their respective

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[121] Specifically, § 22(c) of the CEA and § 28(a) of the SEA contain the actual damages language for private rights of action under the respective Acts. *Cannon*, 230 B.R. at 594 n.71.

[122] *Leist,* 638 F.2d at 298 n.14.

[123] *See Curran*, 456 U.S. at 379 ("The routine recognition of a private remedy under the CEA prior to our decision in *Cort v. Ash* was comparable to the routine acceptance of an analogous remedy under the Securities Exchange Act of 1934."); Sackheim, *supra* note 49, at 82 (explaining that the CFTC was modeled after the SEC).

[124] *Curran*, 456 U.S. at 379.

[125] Sackheim, *supra* note 49, at 82 (noting that the CFTC was modeled after the SEC).

[126] H.R. REP. 97-565, pt. 2, at 5 (1982). The original purposes of the CEA were "providing opportunities for hedging against future price fluctuations in commodities and mechanisms for locking in commodity prices at future dates." *Id.* at 4.

[127] *Id.* at 5.

products be harmonized."[128]

Such parallelism in regulatory advancements in the SEA and CEA leads to a common sense conclusion that interpretation of the actual damages provision in the CEA should also parallel the interpretation of actual damages in the SEA—an issue that the *Loftsgaarden* case addressed.[129]

1. Randall v. Loftsgaarden*: A Flexible Interpretation of Actual Damages under the SEA*

Randall v. Loftsgaarden, the leading case in support of a flexible interpretation of actual damages under the SEA, is persuasive for finding a similar flexible interpretation of the same language under the CEA.[130] The case involved investors who were fraudulently induced to buy into a real estate tax shelter scheme that was intended to provide a tax benefit to investors by creating more deductible expenses.[131] The jury found the defendant liable under § 12(2) of the Securities Act of 1933,[132] § 10(b) of the SEA,[133] SEC rule 10b-5[134] and state law securities claims.[135]

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[128] *Id*. at 13–14.

[129] *See* Randall v. Loftsgaarden, 478 U.S. 647, 663 (1986).

[130] *See In re* Cannon, 230 B.R. 546, 593–95 (W.D. Tenn. 1999) (using *Loftsgaarden* rationale to determine the extent of actual damages under the CEA); Apex Oil Co. v. DiMauro, 744 F. Supp. 53, 54–56 (S.D.N.Y. 1990) (discussing *Loftsgaarden* to determine if actual damages required an offset for plaintiff gains under the CEA); Minpeco v. Conticommodity Services, Inc., 676 F. Supp. 486, 490–95 (S.D.N.Y. 1987) (using *Loftsgaarden* to determine the extent of actual damages under the CEA).

[131] *Loftsgaarden*, 478 U.S. at 650–51.

[132] § 12(2) of the Securities Act of 1933 "provides that an investor harmed by prospectus fraud may sue 'to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon tender of such security, or for damages if he no longer owns the security.'" *Id.* at 651–52 (citing 15 U.S.C. § 77l(2)).

[133] 15 U.S.C. § 78j(b); *see* Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353, 389 n.88 (1982) (noting that the wording of § 4(b) of the CEA and § 10(b) of SEA is similar).

[134] 17 CFR § 240.10b-5 (1985); *See* Sackheim, *supra* note 49, at 82 (noting similarity between § 4b of CEA to antifraud provisions of the SEA, §

Because the plaintiffs' investments were worthless by the time they brought suit, the trial court ordered a full rescissory remedy under § 12(2).[136]

The United States Court of Appeals for the Eighth Circuit reversed and remanded for a new trial.[137] It held that both § 12(2) and § 10(b) needed to comport with the theory of actual damages permitting a plaintiff to recover no more than the equivalent of the harm suffered, and as such, the measure of rescission should have been offset by the amount received in tax benefits stemming from the investment.[138] The court reasoned that the § 10(b) claim was dependent on § 28(a) of the SEA, which limits recovery to actual damages.[139] The Eighth Circuit noted, in reference to the § 12(2) claim, that although "the words 'actual damages' do not appear in the 1933 Act, . . . [rescission should be] substantially equivalent to the damages permitted under section 28(a)."[140] In essence, the court found that although a rescissory remedy, authorized under § 12(2), would award the plaintiff with more than actual damages, recovery should be limited to the harm suffered because the defendant was also found liable under § 10(b), which limits recovery to actual damages.[141]

The Supreme Court reversed, holding that the tax benefits received were not income received and thus should not have offset

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10(b) and Rule 10b-5; also noting same standard of proof applied in SEC and CFTC administrative enforcement proceedings).

[135] *Loftsgaarden*, 478 U.S. at 651.

[136] 15 U.S.C. § 77l(2) (2007).

[137] *Loftsgaarden*, 478 U.S. at 652.

[138] *Id*.

[139] § 28(a) provides that "no person permitted to maintain a suit for damages under the provisions of this chapter 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." 15 U.S.C. § 78bb(a).

[140] Randall v. Loftsgaarden, 768 F.2d 949, 954 (8th Cir. 1986). Under the rescissory approach originally employed by the District Court, plaintiffs would have been entitled to total recoveries ranging from $64,610 to $96,385. Under the Court of Appeals' final ruling, however, plaintiffs could recover only amounts ranging from $506 to $7,666. *Id*. at 961.

[141] *Id*. at 954.

the recovery provided for by the District Court.[142] The Court agreed with the Court of Appeals that § 28(a) of the SEA strictly limits recovery to actual damages.[143] Nonetheless, it held rescission to be the appropriate remedy, implying that actual damages in the context of the SEA are not limited to strict compensatory damages.[144]

Loftsgaarden is an important decision for two reasons. First, it provided a basis for a remedy of rescission for a § 10(b) claim, despite language within § 28(a) of the SEA limiting recovery to actual damages.[145] Second, in dicta, *Loftsgaarden* implied that recovery under the actual damages language of § 28 (a) of the SEA is flexible and could be greater than a party's out-of-pocket loss.[146]

Loftsgaarden demonstrated a logical basis for finding that rescission is at times an appropriate remedy under the SEA.[147] The Court noted that § 12(2), which provides for a remedy of rescission, was not amended a year after its enactment when § 28(a), providing for actual damages on § 10(b) claims, was enacted.[148] It reasoned, therefore, that § 28(a) was not intended to limit the measure of recovery provided for by § 12(2).[149] If there is no mandatory offset for rescission under § 12(2), the same should be true for § 10(b). Consequently, unless Congress intended to have inconsistent results for the same remedy, offsetting limitations to rescission should not be compulsory.[150]

Aside from having a logical basis, the Court also found circuit

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[142] *Loftsgaarden*, 478 U.S. at 658. The theory is that if tax benefits were income received then they would offset the recovery under a rescissory remedy. *Id*.

[143] *Id.* at 660.

[144] *Id*.

[145] *Id.* at 662.

[146] *Id.* at 663–64. The Court found that the tax benefits that the plaintiffs received were not sufficient to be considered windfalls and the tax code would serve to reduce any gains that the plaintiffs received as a result of the damages awarded. *Loftsgaarden*, 478 U.S. at 663–64.

[147] *Id.* at 661.

[148] *Id*.

[149] *Id*.

[150] *Id.* at 662–63.

court precedent for the rescission remedy under SEA § 28(a).[151] The Ninth Circuit stated, in *Blackie v. Barrack,* that "[w]hile out of pocket loss is the ordinary standard in a 10b-5 suit, it is within the discretion of the district judge in appropriate circumstances to apply a rescissory measure."[152] The *Loftsgaarden* Court, citing *Blackie v. Barrack* with approval, shows that, in certain situations, a more expansive definition of actual damages may be appropriate.

In fact, the Court in *Loftsgaarden* went so far as to label recovery under § 28(a) of the SEA as "flexible."[153] The Court recognized that one of Congress's intentions in enacting the SEA was to deter fraud and manipulative practices in the securities markets[154] and that strict adherence to the dictionary definition of actual damages would contradict that salutary purpose.[155] Thus, the Court reasoned that deterrence warranted a flexible interpretation of actual damages.[156] In those situations where the defendant stands to benefit from his fraudulent behavior because he received more than the plaintiff lost, "[it] is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them."[157] A contrary decision would provide an incentive for fraudulent behavior because it would protect perpetrators of securities fraud from liability to many of their victims.[158]

This circumstance led the Court in *Loftsgaarden* to find that "the mere fact that the receipt of . . . benefits, plus a full recovery under a rescissory measure of damages, may place a § 10(b) plaintiff in a better position than he would have been in absent the

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[151] *Id.* at 662.

[152] Blackie v. Barrack, 524 F.2d 891, 909 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976).

[153] *Loftsgaarden*, 478 U.S. at 663.

[154] S. REP. NO. 97-495, at 2 (1982).

[155] Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); *see also* Herman v. MacLean, 459 U.S. 375, 386–87 (1983); Sec. Exch. Comm'n v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963).

[156] *Loftsgaarden*, 478 U.S. at 663.

[157] Janigan v. Taylor, 344 F.2d 781, 786 (8th Cir. 1965); *see also* Falk v. Hoffman, 233 N.Y. 199 (1922) (Cardozo, J.).

[158] *Loftsgaarden*, 478 U.S. at 664.

fraud, does not establish that the flexible limits of § 28(a) have been exceeded."[159] Thus, the Court seemed to believe that, in certain factual situations, it is not anathematic to the meaning of actual damages for a plaintiff to be made more than whole.[160]

2. Commodities Cases After Loftsgaarden

The principle enunciated in *Loftsgaarden*—that a fraudulent party should not be allowed to benefit from his fraud[161]—has been recognized in a number of commodities cases.[162] However, such decisions have not always resulted in the plaintiff recovering

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[159] *Id.* at 663.

[160] *Id.* at 666–67. The Court restricted its holding to the facts of the case and found that in certain situations courts can use their discretion, where appropriate, to bar a rescission remedy under § 10(b). *Id.* The Court noted the potential for abuse; wherein § 12(2) plaintiffs will wait until they get their tax benefits and then file their claims for rescission, thereby maximizing their return on the investment that went wrong. *Id.* The Court thought that other courts could adequately deal with this potential abuse by barring rescissory recovery in those circumstances. *Id.* at 666. Nonetheless, the Court held that in this circumstance the rescissory recovery under § 12(2) is not required to be offset by the tax benefits received under the tax shelter investment, despite the fact that it may make the plaintiff more than whole. *Loftsgaarden*, 478 U.S. at 667.

Some courts before *Loftsgaarden* ruled out a rescission remedy under § 10(b). *See e.g.,* Harris Trust and Savings Bank v. Ellis, 810 F.2d 700, 706 (7th Cir. 1987), and at least one circuit has continued to bar rescission for such claims. *See* Zahorik v. Smith Barney, Harris Upham & Co., 1987 U.S. Dist. LEXIS 14085, *4 (N.D. Ill. May 15, 1987). However, the majority of federal circuits have followed *Loftsgaarden*. *See, e.g.,* Lawton v. Nyman, 327 F.3d 30, 45–46 (1st Cir. 2003); *In re* Broderbund/Learning Co. Sec. Litig. v. Mattell, Inc., 294 F.3d 1201, 1206 (9th Cir. 2002); DCD Programs v. Leighton, 90 F.3d 1442, 1451 (9th Cir. 1996); McMahan & Co. v. Wherehouse Entm't, 65 F.3d 1044 (2d Cir. 1995); Anixter v. Home-Stake Prod. Co., 977 F.2d 1549, 1553–54 (10th Cir. 1992); Rousseff v. E.F. Hutton Co., 843 F.2d 1326, 1328–29 (11th Cir. 1988); Lycan v. Walters, 904 F. Supp. 884 (S.D. Ind. 1995); Prudential-Bache Secur., Inc. v. Cullather, 678 F. Supp. 601, 607 (E.D. Va. 1987).

[161] *Loftsgaarden*, 478 U.S. at 663–64.

[162] *See* Apex Oil Co. v. DiMauro, 744 F. Supp. 53, 55 (S.D.N.Y. 1990); Minpeco v. Conticommodity Services, Inc., 676 F. Supp. 486, 489 (S.D.N.Y. 1987).

damages in excess of his out-of-pocket losses.[163] These courts have recognized that recovery beyond out-of-pocket loss is appropriate only if limiting recovery would contradict goals of equity or deterrence.[164] It appears from the cases that when policy goals of equity or deterrence are sufficiently great, a flexible interpretation of actual damages and thus, a recovery beyond out-of-pocket loss is appropriate.[165]

This principle is well illustrated in the commodity arena.[166] In *Minpeco v. Conticommodity Services, Inc.,*[167] the defendants manipulated the silver market in violation of the CEA and the plaintiff sought out-of-pocket losses and lost profits.[168] With regard to the out-of-pocket losses, the court found that the losses must be offset by the gain in value of their silver holdings, thus limiting the recovery to net economic injury.[169] Despite so holding, the court read the *Loftsgaarden* decision "as supporting the proposition that there is no rigid requirement that a plaintiff must always be limited to its net economic injury where such a limitation would be inequitable or contrary to deterrent goals."[170] The plaintiffs in *Minpeco* were limited in recovery to their net economic loss because they "made no showing that if an offset [was] imposed [there] defendants [would] be either unjustly enriched or sheltered from any 'appreciable liability' as in *Loftsgaarden*."[171] Nevertheless, the district court recognized the availability of broader recovery where appropriate.[172]

Another commodities case that acknowledged the principle set forth in *Loftsgaarden* is *Apex Oil Co. v. DiMauro*.[173] In *Apex Oil Co.*, the claimant actually profited from the fraudulent practices of

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[163] *Apex*, 744 F. Supp. at 55; *Minpeco*, 676 F. Supp. at 489.
[164] *Minpeco,* 676 F. Supp. at 489.
[165] *See id.*; *Apex*, 744 F. Supp. at 55.
[166] *See Apex*, 744 F. Supp. at 55; *Minpeco,* 676 F. Supp. at 489.
[167] 676 F. Supp. 486 (S.D.N.Y. 1987).
[168] *Id.* at 487.
[169] *Id.* at 490.
[170] *Id.*
[171] *Id*.
[172] *Id*. at 489.
[173] 744 F. Supp. 53 (S.D.N.Y. 1990).

the defendant.[174] The plaintiff wanted the court to give him a windfall by awarding him the profits gained by the defendant as a result of the fraudulent conduct,[175] and cited *Loftsgaarden* to support the idea that such an award would accomplish the deterrent goals enunciated in the decision.[176] The court rejected that idea because the plaintiff profited from the fraud.[177] In so holding, the court decided that deterrence alone could not justify such a recovery.[178] However, the court did support the reading of *Loftsgaarden* in *Minpeco* that damages can make plaintiffs more than whole if they are awarded in the interests of equity or deterrence.[179] Therefore, it appears the inequity that would result from the requested damage award was great enough to overcome deterrence concerns.

In order to effectively deter fraudulent misconduct in the securities field, the meaning of actual damages has been construed broadly, thereby allowing for either rescission or disgorgement.[180] In light of the Congressional findings for the 1982 amendments to the CEA and the overlapping nature of the securities and

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[174] *Id.* at 54. The decision dealt only with the damages to be awarded for the remaining counterclaims from a related commodities fraud litigation. *Id*.

[175] *Id.* at 54–55.

[176] *Id.* at 55.

[177] *Id.* at 56.

[178] *Id*.

[179] *Apex*, 744 F. Supp. at 56 (S.D.N.Y. 1990).

[180] *See* Kane v. Shearson Lehman Hutton, Inc., 916 F.2d 643, 646–47 (11th Cir. 1990) (awarding, in a securities action under state law, where the award of damages is, by statute, the same as it is under federal law, rescissory damages and citing the same deterrence principle espoused in *Loftsgaarden* as its reasoning); Estate of Pidcock v. Sunnyland America, 726 F. Supp. 1322, 1329 (S.D. Ga. 1989) ("In the case of a defrauded seller in an action brought under Rule 10b-5, 'where the defrauding purchaser receives more than the seller's actual loss, the damages are the purchaser's profits.' . . . Moreover, once the element of fraud has been established, as it was in this case, 'any profit subsequently realized by the defrauding purchaser should be deemed the proximate consequence of the fraud.'"[citations omitted]); *In re* Der, 113 B.R. 218, 231 (Bankr. D. Md. 1989) (citing Randall v. Loftsgaarden, 478 U.S. 647, 662 (1986)) (supporting a "rescissory" measure of recovery); *see also* Siebel v. Scott, 725 F.2d 995, 1001 (5th Cir. 1984); Lawton v. Nyman, 357 F. Supp. 2d 428, 442 (D.R.I. 2005).

commodities markets,[181] this idea should apply to the CEA as well as the SEA. Accordingly, several courts in the commodities context have allowed recovery of gross trading losses as a result of fraudulent misconduct without an offset for profitable trades.[182] Other courts have allowed recovery of lost profits to the extent that evidence permits a jury to extrapolate what the position of the markets would have been absent the fraud.[183]

In light of the *Minpeco* and *Apex Oil Co.* cases, it is sensible to apply the rationale employed in *Loftsgaarden*—conferring a benefit on the defrauded party rather than permitting the miscreant to keep the proceeds of his fraud—to the recovery of damages under the CEA. The application of the *Loftsgaarden* principle, however, is not without limitations. The *Minpeco* and *Apex Oil Co.* cases also show that the Court's reasoning in *Loftsgaarden* should be applied with discretion[184] and should only have an effect when "limitation [of recovery] would be inequitable or contrary to deterrent goals."[185]

Loftsgaarden should not be interpreted as requiring recovery beyond out-of-pocket loss in the context of § 10(b) and Rule 10b-5 claims under § 28(a) of the SEA. Rather, *Loftsgaarden* put forth alternative means of recovery that are appropriate in certain

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[181] H.R. REP. 97-565, pt. 2, at 13 (1982).

[182] *See generally* Kuhland v. Lincolnwood, Inc., No. R 79-493-80-47, 1986 WL 65629 (C.F.T.C. Mar. 14, 1986); Gatens v. Int'l Precious Metals Corp., No. R 81-673-05, 1985 WL 55298 (C.F.T.C. June 18, 1985); DeAngelis v. Shearson/Am. Express, Inc., No. R 80-1278-81-187, 1984 WL 47628 (C.F.T.C. Mar. 14, 1984).

[183] *See generally* Minpeco v. Conticommodity Services, Inc., 676 F. Supp. 486 (S.D.N.Y. 1987); Strobl v. N.Y. Mercantile Exch., 582 F. Supp. 770 (S.D.N.Y. 1984).

[184] *See* Rowe v. Maremont Corp., 650 F. Supp. 1091, 1113 (N.D. Ill. 1986) (acknowledging, in a securities law case under § 28(a) of the SEA, the availability of rescissory or disgorgement damages under the same line of reasoning as in *Loftsgaarden* but not awarding either based on the facts of the case); *see also* C. C. Whittaker v. Wall, 226 F.2d 868, 872 (8th Cir. 1955) ("It would be a perversion of the statute to allow remittances made in conjunction with a void and unlawful security to be exempt from restitution, and would permit unjust enrichment under the guise of statutory definition.").

[185] *Minpeco*, 676 F. Supp. at 490.

circumstances to accomplish the policy goals expressed in the SEA.[186] Many cases, such as *Minpeco* and *Apex Oil Co.*, still award actual damages according to the traditional, strict interpretation of actual damages, notwithstanding the decision in *Loftsgaarden*.[187] In many cases, especially those where a defendant does not stand to benefit from the fraud by virtue of the penalty imposed or where deterrence and equity goals would not be served by a recovery beyond out-of-pocket loss, the strict interpretation of actual damages is appropriate. Therefore, a more widespread application of flexible actual damages in this area is likely to be reserved for the most egregious and inequitable situations.

3. Securities Law Should be a Guide to Interpreting Actual Damages Under the CEA

Given the similar wording of § 22(c) of the CEA and § 28(a) of the SEA,[188] the similarities in purpose and legislative approach of the two Acts[189] and the growing overlap of markets,[190] the interpretation of actual damages in the CEA should be consistent with the interpretation of the same language in the SEA. Using the SEA as a guidepost to determining damages under the CEA is a sensible method that has already been adopted by courts.[191] In particular, courts have used the decision in *Loftsgaarden* to infer that actual damages can provide for "different measures of

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[186] Randall v. Loftsgaarden, 478 U.S. 647, 662 (1986) (citing Blackie v. Barrack, 524 F.2d 891, 909 (9th Cir. 1975)).

[187] *See Minpeco*, 676 F. Supp. at 490; *Rowe*, 650 F. Supp. at 1113; Apex Oil Co. v. DiMauro, 744 F. Supp. 53, 56 (S.D.N.Y. 1990); *see also* Pelletier v. Stuart-James Co., 863 F.2d 1550, 1559 (11th Cir. 1989) (deciding in a Rule 10b-5 case, despite citing precedent for rescissory remedies, the appropriate measure of damages to be strict actual damages and awards nothing for failure to prove any out-of-pocket loss).

[188] *In re* Cannon, 230 B.R. 546, 594 n.71 (W.D. Tenn. 1999).

[189] Leist v. Simplot, 638 F.2d 283, 298 n.14 (2d Cir. 1980).

[190] H.R. REP. 97-565, pt. 2, at 5 (1982).

[191] *Cannon*, 230 B.R. at 594 (reading from *Loftsgaarden*, that strictly adhering to a narrow definition of actual damages that limits plaintiffs to their net economic loss, works contrary to the deterrent purpose of the Act); *see also Apex*, 744 F. Supp. at 55; *Minpeco*, 676 F. Supp. at 490.

recovery" beyond net economic loss, "including rescission and restitution."[192] Some courts have used the *Loftsgaarden* decision to analyze how damages for a CEA violation could be awarded but have not gone so far as to award damages beyond the standard net economic loss.[193] Still, there is a growing recognition among judges that actual damages in CEA cases may be measured in ways that exceed mere net economic loss.[194] The decision in *In Re Cannon* shows that where "true compensatory damages are not accurately represented by [] 'net economic loss,' but rather, by . . . the gross losses in [an] account," an expanded interpretation of the actual damages provision of the CEA would be appropriate.[195]

D. Other Areas of Law Support the Same Principle that Calls for a Flexible Interpretation of Actual Damages

The rationale that allowed the *Loftsgaarden* Court to award rescissory damages despite a statutory limitation to actual damages is neither unique to that case nor to securities law.[196] For example, copyright law provides for actual damages, including the infringer's profits or, in the alternative, statutory damages.[197] "Courts and

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[192] *See Cannon*, 230 B.R. at 594.

[193] *Apex*, 744 F. Supp. at 58; *Minpeco*, 676 F. Supp. at 494–95.

[194] *Cannon*, 230 B.R. at 595.

[195] *Id*.

[196] Randall v. Loftsgaarden, 478 U.S. 647, 663 (1986). *See also* On Davis v. The Gap, Inc., 246 F.3d 152, 164 (2d Cir. 2001) (invoking a similar principle of construction to favor victims of copyright infringement over infringers); Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965) ("[It] is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them."); *see generally* Falk v. Hoffman, 233 N.Y. 199 (1922) (Cardozo, J.).

[197] 17 U.S.C.A. § 504 (2004). § 504 provides:

> (a) In general. Except as otherwise provided by this title, an infringer of copyright is liable for either-
>
> (1) the copyright owner's actual damages and any additional profits of the infringer, as provided by subsection (b); or
>
> (2) statutory damages, as provided by subsection (c).
>
> (b) Actual damages and profits. The copyright owner is entitled to

commentators agree [that actual damages] should be broadly construed to favor victims of [copyright] infringement."[198] In *On Davis v. The Gap*,[199] the Second Circuit used reasoning similar to that used by the Supreme Court in *Loftsgaarden* to find that licensing fees should be included in actual damages when no actual damages for copyright infringement can be proved.[200] In the court's view, "as between leaving the victim of the illegal taking with nothing, and charging the illegal taker with the reasonable cost of what he took, the latter, at least in some circumstances, is the preferable solution."[201] Moreover, "[t]o rule that the owner's loss of the fair market value of the license fees he might have exacted of the defendant do not constitute 'actual damages,' would mean that

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> recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages. In establishing the infringer's profits, the copyright owner is required to present proof only of the infringer's gross revenue, and the infringer is required to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.

Id.

[198] *Davis*, 246 F.3d at 164. This appears to be the same principle that is enunciated in *Loftsgaarden* and there is ample support for this construction of actual damages in copyright case law. *See* WILLIAM F. PATRY, COPYRIGHT LAW AND PRACTICE 1167 (1994) ("Within reason, any ambiguities should be resolved in favor of the copyright owner."); 4 NIMMER ON COPYRIGHT § 14.02A, 14–12 (2007) ("Uncertainty will not preclude a recovery of actual damages if the uncertainty is as to amount, but not as to the fact that actual damages are attributable to the infringement."); Fitzgerald Publ'g Co. v. Baylor Publ'g Co., 807 F.2d 1110, 1118 (2d Cir. 1986) ("[A]ctual damages are not . . . narrowly focused."); Sygma Photo News, Inc. v. High Society Magazine, 778 F.2d 89, 95 (2d Cir. 1985) (stating that when courts are confronted with imprecision in calculating damages, they "should err on the side of guaranteeing the plaintiff a full recovery"). *Cf.* In Design v. K-Mart Apparel Corp., 13 F.3d 559, 564 (2d Cir. 1994) (noting that any doubts in calculating profits which result from the infringer's failure to present adequate proof of its costs are to be resolved in favor of the copyright holder), *abrogated on other grounds* Fogerty v. Fantasy, Inc., 510 U.S. 517 (1994).

[199] 246 F.3d 152 (2d Cir. 2001).

[200] *Id.* at 164.

[201] *Id.* at 166.

in such circumstances an infringer may steal with impunity."[202] Based on that reasoning, the court found that even though the statute specified actual damages, the "statutory term 'actual damages' is broad enough" to cover this type of recovery.[203]

Property law, which has historically applied the disgorgement principle in cases of intentional fraud,[204] is another example of an expansive interpretation of actual damages. In *Dickson v. Patterson*,[205] a property fraud case, the Supreme Court held that the disgorgement of profits obtained from the fraudulent transaction was the appropriate remedy.[206] In *Dickson*, the defendant and the plaintiff each bought a half interest in the same property.[207] The defendant then sold both parties' property interests for a modest profit to a third party.[208] The defendant, unbeknownst to the plaintiff, bought the property back from the third party at the same price and sold part of it again on his own to a fourth party for a substantial profit.[209] The Court found this to be impermissible and fashioned a remedy whereby the deeds executed with fraudulent intent were set aside, leaving the property in the state it was before the fraud began and, in addition, the fraudulent party was compelled to disgorge half of the profits he made from the fraudulent transactions.[210] The Court in *Loftsgaarden* applied a similar remedy whereby the plaintiff was able to retain the tax benefits resulting from the investment in the tax shelter and also receive rescission, thereby returning him to the position he was in prior to the fraud.[211]

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[202] *Id*.

[203] *Id*. *See also* Harper & Row, Publishers, Inc. v. Nation Enters., 471 U.S. 539 (1985) (there the Supreme Court intimated, similarly to the court in *Davis,* that royalties would be recoverable under actual damages).

[204] Restatement First of Restitution § 151, 202 Cmt. b, c (1937); 4 Scott, Trusts §§ 507, 508, 508.1 (2d ed. 1956).

[205] 160 U.S. 584 (1896).

[206] *Id*. at 592.

[207] *Id*. at 586.

[208] *Id*.

[209] *Id*. at 587.

[210] *Id*. at 592.

[211] Randall v. Loftsgaarden, 478 U.S. 647, 667 (1986).

The *Loftsgaarden* principle does not stand alone. It is paralleled in other areas of law and should be applied to commodities law. Although the statute restricts recovery to "actual damages," that term can be interpreted broadly enough to avoid the injustice and perverse policy that would result from a narrow interpretation.

E. The Need for a Flexible Interpretation of Actual Damages Despite the Powers of the CFTC

The CFTC has the power to bring suit in district court against violators of the CEA.[212] In doing so, it can ask for remedies, including disgorgement of profits,[213] monetary penalties[214] and a permanent injunction.[215] Given that the CFTC can stop defendants from profiting from their wrongdoing by bringing suit in district court,[216] one may wonder why disgorgement or rescission would be an appropriate remedy under the private right of action for actual damages.

There are many benefits to allowing a private right of action for actual damages. First, such private actions add to the efficiency of the court system.[217] Also, this would help ease the burden on the "overburdened" CFTC reparations program.[218] Further, Congress has indicated that providing for a private right of action and awarding a successful plaintiff actual damages would provide immediate relief to commodity investors from fraud.[219] The reason that commodity investors needed this avenue of relief was because of the shortcomings of the reparations section of the CFTC.[220] The

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[212] 7 U.S.C. § 13a-1 (2000); *see also* Commodities Futures Trading Comm'n v. Heffernan, 274 F. Supp. 2d 1375 (S.D. Ga. 2003).

[213] *Heffernan*, 274 F. Supp. 2d at 1382.

[214] 7 U.S.C. § 13a-1(d)(1).

[215] 7 U.S.C. § 13a-1(a)–(b); Commodities Futures Trading Comm'n v. Muller, 570 F.2d 1296, 1299-1300 (5th Cir. 1978).

[216] 7 U.S.C. § 13a-1.

[217] S. REP. NO. 97-495, at 51 (1982).

[218] *Id.*

[219] *Id*.

[220] *Id*.

Senate Committee referred to a private right of action as "one possible solution to the . . . ineffectiveness of the CFTC reparations program."[221]

There are also many advantages to permitting the courts to interpret actual damages loosely to allow for disgorgement of profits or rescission in situations where the defendant stands to profit from his misconduct. Aside from easing the burden on the CFTC, it would also promote efficiency in the courts; assuming that private rights of action will be brought prior to CFTC proceedings, the issue of disgorgement would not need to be litigated in front of the CFTC because the manipulators will have already been shorn of all their profits.[222] Fewer litigable issues would necessarily speed up the trial process and allow for the resolution of more CFTC initiated claims. Commodities customers would continue to exercise their rights to initiate proceedings under the CEA.[223] Thus, it is sensible to implement a more flexible interpretation of actual damages if such a shift can further relieve the "erratic, overburdened and rarely effective"[224] CFTC reparations program.

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[221] *Id*. Allowing the district courts the flexibility of interpreting actual damages in certain situations to permit disgorgement is not without judicial support. Commodities Futures Trading Comm'n v. Muller, 570 F.2d 1296, 1300 (5th Cir. 1978). "In an action to enforce the requirements of a remedial statute, such as the Commodity Exchange Act ('the CEA'), a district court 'has broad discretion to fashion appropriate relief.'" Commodities Futures Trading Comm'n v. Heffernan, 274 F. Supp. 2d 1375, 1379 (S.D. Ga. 2003) (citing *Muller*, 570 F.2d at 1300).

[222] The assumption that private rights of action would be brought prior to a CFTC proceeding is reasonable because if a CFTC proceeding predated the private action, then the likelihood is that the profits will have already been disgorged and penalties will have been assessed. Thus, there will be nothing left for the private investor to recover. In addition, it will be presumed that because of the heavy load of the CFTC, there will be a delay in their bringing actions against manipulators.

[223] 7 U.S.C. § 25 (2000).

[224] S. REP. NO. 97-495, at 51.

V. ACTUAL DAMAGES UNDER THE CEA

This Note suggests two solutions to resolve the problem presented when, in the context of a private right of action under the CEA, the defendant stands to benefit from his misconduct because he profited more than the plaintiff lost. For either solution to be effective, a flexible interpretation of actual damages is a necessary predicate.

The first solution is simply using a flexible interpretation of actual damages that can be applied by the courts based on the factual circumstances. In the situation explored in this Note, courts could either afford a remedy of full rescission for situations similar to that in *Loftsgaarden* or they could provide for disgorgement of the defendant's profits, usually resulting in a windfall to the victim of the fraud, as has happened in some rule 10b-5 cases.[225]

A court, in determining whether to apply a remedy of rescission or disgorgement, would need guidance as to when and how to apply such remedies. The courts could look directly to securities law and in particular the line of cases following *Loftsgaarden* to determine the level of proof required to support either remedy.[226] There is ample case law in the securities realm

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[225] *See* Lawton v. Nyman, 357 F. Supp. 2d 428, 442 (D.R.I. 2005); Estate of Pidcock v. Sunnyland America, 726 F. Supp 1322, 1329 (S.D. Ga. 1989). It is important to note that a remedy of disgorgement in both securities and commodities law is the result of an exercise of a district court's equitable powers. Sec. Exch. Comm'n v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978); *Heffernan*, 274 F. Supp. 2d at 1379. Thus, simply proving a violation of either statute would give the court "power to fashion an appropriate remedy." Sec. Exch. Comm'n v. Manor Nursing Centers, 458 F.2d 1082, 1103 (2d Cir. 1972).

[226] *See Pidcock*, 726 F. Supp. at 1329 ("In the case of a defrauded seller in an action brought under Rule 10b-5, 'where the defrauding purchaser receives more than the seller's actual loss, the damages are the purchaser's profits.' . . . Moreover, once the element of fraud has been established, as it was in this case, 'any profit subsequently realized by the defrauding purchaser should be deemed the proximate consequence of the fraud.'" [citations omitted]); *In re* Der, 113 B.R. 218, 231 (Bankr. D. Md. 1989) (citing Randall v. Loftsgaarden, 478 U.S. 647, 662 (1986)) (supporting a "rescissory" measure of recovery); *see also* Siebel v. Scott, 725 F.2d 995, 1001 (5th Cir. 1984); *Nyman*, 357 F. Supp. 2d

that has followed the *Loftsgaarden* decision and would provide a useful starting point for courts in determining when to apply either rescissory or disgorgement damages.[227]

In the alternative, this Note proposes a second solution. The profits retained by a defendant beyond what the plaintiff is entitled to recover could be disgorged and transferred into a fund or trust under the control of the CFTC for the purpose of offering aid to the victims of commodities fraud. There is support for a judicially imposed remedy of this sort.[228] Under Rhode Island law, for example, a constructive trust can be imposed as a remedy for unjust enrichment.[229] Under securities law, a common fund or trust can be established to benefit all plaintiffs in class actions alleging an unjust enrichment claim.[230] The court, in *Sec. Exch. Comm'n. v. Glauberman,* recognized that "disgorgement is a well recognized device to undo unjust enrichment resulting from illegal securities trading."[231] The court implied that a constructive trust would be imposed on money obtained through unjust enrichment.[232] It then presumed that the money in the fund would be put toward the benefit of the victims of the fraud or in the alternative would go into the treasury.[233]

In fact, Congress established just this sort of fund under securities law, called Fair Funds, when it enacted the Sarbanes-

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at 442.

[227] *See generally* Lawton v. Nyman, 327 F.3d 30 (1st Cir. 2003); *In re* Broderbund/Learning Co. Sec. Litig., 294 F.3d 1201 (9th Cir. 2002); DCD Programs v. Leighton, 90 F.3d 1442 (9th Cir. 1996); McMahan & Co. v. Wherehouse Entertainment, 65 F.3d 1044 (2d Cir. 1995); Anixter v. Home-Stake Prod. Co., 977 F.2d 1549 (10th Cir. 1992); Rousseff v. E.F. Hutton Co., 843 F.2d 1326 (11th Cir. 1988); Lycan v. Walters, 904 F. Supp. 884 (S.D. Ind. 1995); Prudential-Bache Secs., Inc. v. Cullather, 678 F. Supp. 601 (E.D. Va. 1987).

[228] *Nyman*, 357 F. Supp. 2d at 434.

[229] *Id*.

[230] Everett v. Verizon Wireless, Inc., 460 F.3d 818, 824 (6th Cir. 2005); Sec. Exch. Comm'n v. Glauberman, 90 Civ. 5205, 1992 U.S. Dist. LEXIS 10982, at *3 (S.D.N.Y. July 16, 1992).

[231] *Glauberman*, 1992 U.S. Dist. LEXIS, at *3.

[232] *Id*.

[233] *Id*. at *4.

Oxley Act of 2002.[234] The SEC provided for the same fund using the same language from the Sarbanes-Oxley Act, in Rule 1100,[235] which provides:

> In any agency process initiated by an order instituting proceedings in which the Commission or the hearing officer issues an order requiring the payment of disgorgement by a respondent and also assessing a civil money penalty against that respondent, the Commission or the hearing officer may order that the amount of the disgorgement and of the civil money penalty, together with any funds received [by the Commission] pursuant to 15 U.S.C. 7246(b), be used to create a fund for the benefit of investors who were harmed by the violation.[236]

A similar type of fund could be imposed on the profits of a CEA violator that go beyond the losses of the plaintiff in an action under 7 U.S.C. § 25. Much like the SEC's handling of Fair Funds, the CFTC could then take control of the fund and distribute the proceeds where needed.

A disgorgement fund, similar to Fair Funds, may not directly create a greater monetary incentive to bringing suit for victims of fraud whose losses were small. However, such a fund would likely give the general public a secure sense that there is justice in the futures markets and that investors are not just the province of predators who calculate ways to steal from their prey through fraud and manipulation. Such a feeling of security and protection would improve investor confidence and encourage more investors to enter the market while simultaneously discouraging manipulation and fraud. Thus, both of the original purposes of the CEA would be served.[237]

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[234] Fair Funds was intended to benefit investors that lost money due to conduct of individuals or corporations that violated securities laws. It allows the SEC to combine disgorgement amounts and civil monetary penalties from securities frauds into one fund to benefit the many victims of these schemes. 15 U.S.C. § 7246(b) (2002).

[235] 17 CFR § 201.1100 (2006).

[236] *Id*.

[237] The purposes of the CEA are: (1) providing for a fair and safe market place by deterring manipulation and fraudulent behavior and (2) preserving the

Regardless of the preferred solution, a more flexible interpretation of actual damages would be a necessary predicate. Thus, arguments in favor of such a flexible interpretation are relevant for determining which solution to apply.

CONCLUSION

This Note has set forth two workable solutions available to the courts. Either solution would address directly the issue of what to do with a defendant's profits that exceed the losses of a plaintiff. Both solutions would avoid the perverse result of the defendant being able to profit from his wrongdoing. In addition, action by the district court in these situations should lighten the load on the CFTC in reparations proceedings. Most importantly, either solution would be in accord with the previously stated legislative goals of Congress;[238] both solutions would help to deter future manipulation and would not have an adverse effect on the hedging function performed by the markets. Either solution would deter potential violators. Honest investors might even be encouraged to invest by virtue of the added level of protection they would receive under the Act. Added deterrence of CEA violations would also help the government maintain a greater measure of control over growing futures markets[239] without discouraging investors and honest speculators.

For the reasons already stated, a prudent policy for courts to follow in regards to the award of actual damages under 7 U.S.C. § 25 is that in situations where the defendant's profits exceed the plaintiff's losses, the court should allow for a measure of recovery greater than out-of-pocket loss because "[it] is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them."[240]

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hedging function of the markets that was deemed essential for the protection of the actual producers and buyers of commodities. *See* S. REP. NO. 97-495 at 2 (1982); Campbell, *supra* note 81, at 223; H.R. REP. NO. 97-565, pt. 2, at 5–6 (1982).

[238] H.R. REP. NO. 421, at 1 (1934).

[239] H.R. REP. 97-565, pt. 2, at 5.

[240] Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965).