Loss Causation and Damages in Securities Fraud Class Actions

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One of the most difficult problems in securities-fraud class actions is how to estimate the harm suffered by class members. In *Reichart v. Shemesh*, the Supreme Court suggested two alternative methods for estimating class members' loss: the "out-of-pocket" method and the "modified out-of-pocket" method. The Court assumed that these two methods would produce similar outcomes. In this article, we explain that the two methods are inherently different, as they estimate the investors' harm at different points in time. The "out-of-pocket" method calculates the harm at the time the fraud was committed (ex ante), whereas the "modified out-of-pocket" method calculates the harm at the time the fraud was discovered (ex post). Although the two methods may sometimes produce similar outcomes, there are cases – and *Reichart* is one of them – where the results would be entirely different.

Our core argument in this article is that the harm to investors should be estimated at the time the fraud was discovered (ex post). This approach exposes the investors to the investment risk which is independent of the fraud perpetrated against them; it conforms to the policy of waiving reliance as a necessary requirement for securities-fraud liability; and, finally, it offers administrative advantages when defining the class and computing its total loss.

The article also proposes an alternative to the "modified out-of-pocket" method. Like the latter, this method also relies on the change in the assets' value at the time the fraud was discovered. It, too, is an ex post method, but it is far easier to implement and often proves more accurate.