Measuring Insider Trading Damages for a Private Plaintiff

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MEASURING INSIDER TRADING DAMAGES FOR A PRIVATE PLAINTIFF

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ABSTRACT

This article discusses various measures of the damages of a private plaintiff who sues a stock market insider trading defendant. The measures are: “pure” out of pocket, “expedient” out of pocket, rescissory, and cover.

The “pure” out of pocket measure is the difference between the transaction price and the real or actual share value. Implicitly, this measure assumes that but-for the defendant’s fraud, the plaintiff would have traded at the same time anyway, but at a better price.

The so-called “expedient” out of pocket measure accepts the “pure” out of pocket measure in principle. Nevertheless, to avoid the practical difficulty of determining the real value of the stock at the time of the plaintiff’s trade, the “expedient” out of pocket measure substitutes for this “true value” the market price after dissemination of the correct or previously nonpublic information. A variant of the “expedient” out of pocket measure looks to either the dollar or percentage price change at curative dissemination and uses this change as a measure of the damages to the plaintiff. The price change at dissemination could be applied to the plaintiff’s transaction price to estimate the true value at the time of the plaintiff’s trade. More complex variations exist to correct for the effects of extraneous factors.

The rescissory measure attempts to undo the fraudulent transaction and return the defrauded party to her position before the fraudulent inducement caused her to enter into the trade. In other words, rescissory damages award a plaintiff the dollar amount at the time of judgment necessary to put her back in her original position prior to the fraudulent transaction. This measure implicitly assumes that the plaintiff would not have traded but-for the defendant’s fraud.

For the rescissory measure, courts usually require the plaintiff to prove a contractual relationship with the defendant. Most stock market insider

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trading plaintiffs are *not in contractual privity* with the defendant. The rescissory measure would give such plaintiffs an unjustified “free ride” to gain speculative profits from stock price changes until the date of judgment without risking any money. Nevertheless, rescissory damages might conceivably be available to a plaintiff *in contractual privity* with an insider trading defendant, especially one liable under the classical relationship theory.

Like the rescissory measure, the cover measure implicitly presumes that the plaintiff would not have traded but-for the defendant’s fraud. This approach also implicitly assumes that the plaintiff is entitled to a rescissory measure of damages. Nevertheless, the cover measure imposes on the plaintiff the obligation to *mitigate* damages by reversing her trade within a “reasonable” time after curative disclosure.

Although this article briefly discusses two additional damage measures, “disgorgement of windfall profits” and “benefit of the bargain,” these two measures are not appropriate in stock market insider trading cases.

To select a “fair” measure of damages, one must know what the plaintiff would have done absent the defendant’s fraud. When the plaintiff bought or sold a publicly traded security, she had an almost infinite number of alternatives. If the plaintiff would have traded at the same time anyway, but at a different price, the “pure” out of pocket or “expedient” out of pocket measures would be appropriate. If the plaintiff would *not* have traded and would have maintained that position until the time of judgment, the rescissory measure might be proper; but fairness might require the plaintiff to mitigate damages, in which case the cover measure would be appropriate.

Knowing what the plaintiff would have done is difficult because any plaintiff testimony may be self-serving. With class actions, the members of the plaintiff class are not even available to give self-serving testimony and, in any event, are not uniform and would have pursued different courses of action absent the fraud. Therefore, no one measure of damages is “fair.”

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INTRODUCTION

This article deals with the measure of damages of a private plaintiff who sues a stock market insider trading defendant. This piece does not cover the size of the class of plaintiffs who can sue such a defendant. In fact, defendants can be liable to “contemporaneous traders,” a class that may be large.

Because of the possibly large number of plaintiffs, if each member of that class could recover actual damages, however measured, the aggregate liability of the defendant could be enormous. In reality, however, the ceiling on the defendant’s liability to contemporaneous traders in an express or implied cause of action is the insider trading profit. Therefore, the pro rata recovery of each plaintiff may be minuscule. If so, the measure of actual damages for each plaintiff may make little difference because each plaintiff receives such a tiny percentage of that damage, however measured. Nevertheless, a court must still determine each plaintiff’s actual damages before awarding a fraction of it.

Furthermore, the party on the other side of the insider trade may conceivably have an implied action for actual damages against a defendant liable under the classical relationship theory. If so, that plaintiff may be able to recover all her actual damages. These damages would have to be measured. Part I below discusses various possible approaches.

I. VARIOUS MEASURES OF ACTUAL DAMAGES

The following are various measures of damages in section 10(b) suits generally: out of pocket, “expedient” out of pocket, rescissory, cover,

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1 For discussion of the class of plaintiffs, see WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING (2d ed. 2008), ch. 6.
2 See id. §§ 6:2, 6:3, 6:4, 6:10.1, 6:11.
3 See id. §§ 6:4, 6:11.
4 See id. §§ 4:8.3[A], 6:2. For related discussion of this ceiling on damages, see infra note 36.
5 See WANG & STEINBERG, supra note 1, §§ 4:8.3[B], 6:3; infra notes 64-65 and accompanying text.
6 See WANG & STEINBERG, supra note 1, § 6:3 n.62-63 and accompanying text.
7 See id. § 6:8.
8 See id. Such a plaintiff may have the alternate remedy of rescission. See id. § 4:9.
9 See infra Part I.A.
10 See infra Part I.B.
11 See infra Part I.C.
12 See infra Part I.D.
disgorgement of windfall profits,\textsuperscript{13} and benefit of the bargain.\textsuperscript{14} Some of these might be appropriate in insider trading cases; others are not.\textsuperscript{15}

The Supreme Court held in \textit{Affiliated Ute Citizens v. United States}\textsuperscript{16} that section 28(a) of the Exchange Act provides the “correct measure of damages” in securities fraud cases.\textsuperscript{17} Section 28(a)\textsuperscript{18} permits the recovery of “actual damages,”\textsuperscript{19} but \textit{Affiliated Ute} did not define the term.\textsuperscript{20} The courts generally agree that section 28(a) allows the recovery of only compensatory, not punitive damages,\textsuperscript{21} and that it prevents double recovery by those who

\textsuperscript{13} See infra Part I.F.

\textsuperscript{14} See infra Part I.G.


This Article does not discuss how to calculate the damages of a plaintiff who bought and sold numerous times during the period of fraud by the defendant. For discussion of this question, see Samuel Francis, Note, \textit{Meet Two-Face: The Dualistic Rule 10b-5 and the Quandry of Offsetting Losses by Gains}, 77 FORDHAM L. REV. 3045 (2009).

\textsuperscript{16} 406 U.S. 128, 155 (1972).

\textsuperscript{17} Id. For discussion of \textit{Affiliated Ute Citizens}’ treatment of damages, see Lowenfels & Bromberg, supra note 15, at 1087-89.

\textsuperscript{18} Section 28(a) provides in pertinent part: “[N]o 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) (2009).

\textsuperscript{19} Id. Herman & MacLean v. Huddleston, 459 U.S. 375, 387-91 (1983), held that in a private civil suit for money damages under § 10(b) and Rule 10b-5, the plaintiff must prove his or her case by a preponderance of the evidence.

\textsuperscript{20} See \textit{Affiliated Ute Citizens}, 406 U.S. at 155.

assert both state and federal claims which arise out of the same conduct. Beyond these points, however, the courts diverge in their interpretation of the proper measure of damages.

A. “Pure” Out of Pocket

The phrase “pure” out of pocket measure is a term invented by the author of this article. For section 10(b)/Rule 10b-5, the “pure” out of pocket measure is the traditional measure of damages. This is the difference

748 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968); Aliken, supra note 15, § 20 (citing numerous cases).

22 See, e.g., Osofsky, 645 F.2d at 111.

23 See Younger, supra note 15, at 19 (“There is a large degree of uncertainty in the law as to the proper method for calculating damages for the antifraud provisions of the federal securities laws.”); cf. Elizabeth Chamblee Burch, Reassessing Damages in Securities Fraud Class Actions, 66 MD. L. REV. 348, 349 (2007) (“[N]o coherent doctrinal statement exists for calculating open-market damages in Rule 10b-5 securities fraud class actions.”).

24 See Ambassador Hotel Co. v. Wei-Chuan Inv., 189 F.3d 1017, 1030 (9th Cir. 1999); Astor Chauffeured Limousine Co. v. Rumfield Inv. Corp., 910 F.2d 1540, 1551 (7th Cir. 1990) (stating “the statutes limit victims to ‘actual damage’, which the courts routinely understand to mean ‘out of pocket loss’ (citations omitted)); Pelletier v. Stuart-James Co., Inc., 863 F.2d 1550, 1557 (11th Cir. 1989); Hackbart v. Holmes, 675 F.2d 1114, 1121 (10th Cir. 1982) (stating “[t]he customary measure of damages in a Rule 10b-5 case is the out-of-pocket loss”); Glick v. Compagna, 613 F.2d 31, 36 (3d Cir. 1979) (“The traditional measure of damages is the difference between the fair value of what the seller receives for his stock and what he would have received had there been no fraudulent conduct.” (dictum)); Madigan, Inc. v. Goodman, 498 F.2d 233, 239 (7th Cir. 1974); Levine v. Seilon, Inc., 439 F.2d 328, 334 (2d Cir. 1971); Estate Counseling Serv., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 303 F.2d 527, 533 (10th Cir. 1962); Edward J. DeBartolo Corp. v. Coopers & Lybrand, 928 F. Supp. 557, 565 (W.D. Pa. 1996); In re Crazy Eddie Sec. Litig., 948 F. Supp. 1154, 1165 (E.D.N.Y. 1995); Janet C. Alexander, Rethinking Damages in Securities Class Actions, 48 STAN. L. REV. 1487, 1490-91 (1996) [hereinafter Rethinking]; Janet C. Alexander, The Value of Bad News in Securities Class Actions, 41 UCLA L. REV. 1421, 1428 (1994) [hereinafter Bad News]; Merritt B. Fox, After Dura: Causation in Fraud-on-the-Market Actions, 31 J. CORP. L. 829, 839 (2006) (stating that “standard measure of damages in Rule 10b-5 cases is ‘out of pocket’”); id. at 845, 863, 870 & n.118 (same); Robert B. Thompson, The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages, 37 VAND. L. REV. 349, 356 (1984) [hereinafter Restitution]; Michael Y. Scudder, Comment, The Implications of Market-Based Damages Caps in Securities Class Actions, 92 NW. U. L. REV. 435, 446 (1997); Younger, supra note 15, at 19-20 (“Most courts have adopted the out-of-pocket rule as the basic measure of damages in Rule 10b-5 actions, and it remains the dominant theory.” (footnote omitted)); see also Randall v. Loftsgaarden, 478 U.S. 647, 662 (1986) (“Courts have also generally applied this ‘out of pocket’ measure of damages in § 10(b) cases involving fraud by a seller of securities . . . .”); Robert B. Thompson, Federal Corporation Law: Torts and Fiduciary Duty, 31 J. CORP. L. 877, 886 (2006) (“The usual measure of recovery for common law fraud and securities fraud has been out of pocket damages . . . .”)[hereinafter Torts]; cf. Affiliated Ute Citizens, 406 U.S. at 155 (“In our view, the correct measure of damages under § 28 of the Act . . . 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, . . . except for the situation where the defendant received more than the
between the transaction price and the real or actual value. 25 Implicitly, this

seller’s actual loss.”). But see Jordan v. Duff and Phelps, Inc., 815 F.2d 429, 441-42 (7th Cir. 1987), cert. denied, 485 U.S. 901 (1988) (stating in dictum that there are two standard measures of damages in securities law: one based on defendant’s gain and one based on plaintiff’s loss).


Randall also noted that “there is authority for allowing the § 10(b) plaintiff, at least in some circumstances, to choose between ‘undoing the bargain . . . or . . . [out of pocket] damages.” 478 U.S. at 662 (quoting LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 1133 (1983)) (brackets in original).

California Corporations Code § 25502 codifies the “pure” out of pocket measure of damages:

Any person who violates Section 25402 shall be liable to the person who purchases a security from him or sells a security to him, for damages equal to the difference between the price at which such security was purchased or sold and the market value which such security would have had at the time of the purchase or sale if the information known to the defendant had been publicly disseminated prior to that time and a reasonable time had elapsed for the market to absorb the information, plus interest at the legal rate . . . .

CAL. CORP. CODE § 25502 (2009).

For a discussion of the out of pocket measure generally and its application to insider trading cases, see Aliken, supra note 15, Part I. For a discussion of the out of pocket measure in issuer misrepresentation cases, see William O. Fisher, The Analyst-Added Premium as a Defense in Open Market Securities Cases, 53 BUS. LAW. 35, 53-54 (1997). For additional discussion of the out of pocket measure, see Scott M. Himes, Measuring Damages for Fraud-Based Mismanagement of a Securities Portfolio, 27 SEC. REG. L.J. 74, 78-80 (1999);
measure assumes that but-for the defendant’s fraud, the plaintiff would have traded at the same time anyway but at a better price.

This approach has the merit of limiting recovery to the plaintiff’s actual loss, thereby eliminating any potential speculative gain. The measure’s principal disadvantage may be the difficulty of establishing actual value at the time of the plaintiff’s trade.


Before a plaintiff is entitled to damages, however, she must demonstrate loss causation. For discussion of the loss causation requirement in civil suits against misappropriators, see WANG & STEINBERG, supra note 1, § 6:10.3 & nn.594-47. For additional discussion of “loss causation,” see Dura Pharm., Inc. v. Broudo, 544 U.S. 336 (2005); WANG & STEINBERG, supra note 1, §§ 3:3.6 n.53, 4.1 n.12 and accompanying text, 4.5 n.475 and accompanying text, 4.9.1 n.744 and accompanying text; 6:10.3 n.594 and accompanying text; infra notes 26, 33.

26 See Younger, supra note 15, at 20 (“[F]ocuses on the plaintiff’s actual or ‘out-of-pocket’ loss rather than speculating about any potential gain from the transaction . . . .”); see also Madigan Inc. v. Goodman, 498 F.2d 233, 239-40 (7th Cir. 1974); cf. Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1343-44 (9th Cir. 1976) (Sneed, J., concurring in part and concurring in result in part) (rejecting rescissory damages and endorsing “pure” out of pocket in one particular case); Restitution, supra note 24, at 357-58 (out of pocket measure prevents plaintiff from shifting market risk to defendant and precludes benefit of bargain measure).

If the plaintiff reverses the transaction prior to any price adjustment (due to curative disclosure by issuer or others), she would have no recovery. One reason would be the need to demonstrate “loss causation.” See Dura, 544 U.S. at 342 (“[I]f, say, the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss.”). Another reason would be because of a limitation on damages. See Fox, supra note 24, at 845 (“[T]he plaintiff’s recovery in damages would be limited to the extent that she receives at the time of sale a benefit arising from the same wrong because of any continuing inflation.”). In this situation, Professor Fox argues for the damages limitation instead of the “loss causation” approach. See id. at 845, 863-64.

Suppose a plaintiff reverses the transaction after curative disclosure at a better price, either: (1) buying before curative disclosure and then selling at a higher price after curative disclosure, or (2) selling before curative disclosure and then buying at a lower price after curative disclosure.

Dura reserved the question whether the plaintiff could recover in this scenario. See Dura, 544 U.S. at 343 (“The same is true in respect to a claim that a share’s higher price is lower than it would otherwise have been—a claim we do not consider here.”); Fox, supra note 24, at 847-48; Ann Morales Olazabal, Loss Causation in Fraud-on-the-Market Cases Post-Dura Pharmaceuticals, 3 BERKELEY BUS. L.J. 337, 361-63 (2006). For an argument that a plaintiff who pays an inflated price because of the defendant’s fraud may be harmed regardless whether the plaintiff eventually sells at a price higher or lower than the original price, see id. at 362-68.

27 Cf. Restitution, supra note 24, at 362-63 (describing use of price at later date as best evidence of what stock was worth at time of plaintiff’s transaction). But see Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1344 (9th Cir. 1976) (Sneed, J., concurring in part and concurring in the result in part) (“[E]stablishing the required value line [value at the
One district court initially adopted the “pure” out of pocket measure of damages in an insider trading case. Upon reconsideration, however, the court used another measure (the “expedient” out of pocket). In the course of refusing to dismiss a complaint in an insider trading case, another district court judge endorsed the “pure” out of pocket measure in dictum.

Despite the lower federal courts’ endorsement of pure out of pocket damages, the Supreme Court opinion in Dura Pharmaceuticals, Inc. v. Broudo, may cast some doubt on the validity of this damage measure in open market transactions. Dura unanimously held that a private Rule 10b-5 complaint insufficiently alleged loss causation if, without any additional elaboration, the complaint stated solely that the plaintiff purchased stock at a price artificially inflated by the defendant’s misstatements. The opinion did not clarify what additional elaboration would suffice.

For additional discussion of possible approaches to determining the true value of a stock at the time of the plaintiff’s trade, see Arthur H. Rosenblum & Kurt Kroboth, Stock Fraud Case Awards? Go Figure, NAT’L L.J., Nov. 4, 1996, at B7; Scudder, supra note 24, at 447-51; infra notes 39-45 and accompanying text. For related discussion of “event study” methodology, the “value line,” and similar approaches, see infra notes 39, 41.


29 See id. at 132-33. For discussion of the revised decision, see infra Parts I.B., I.D. The circuit court opinion summarizes the district court’s revised holding. See Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 162, 168 n.25 (2d Cir. 1980). For discussion of the circuit court’s measure of damages, see infra note 36; infra notes 64-65 and accompanying text.

30 Froid v. Berner, 649 F. Supp. 1418, 1423 (D.N.J. 1986) (nevertheless, court proceeded to grant summary judgment to defendants because “[a] rational fact-finder . . . could not find that defendants possessed any inside information . . . .” Id. at 1425).

In at least one case brought by the SEC seeking disgorgement of insider trading profits, the settlement plan limited recovery from the disgorgement fund to investors who sustained “out-of-pocket losses.” See SEC v. Certain Unknown Purchasers of the Common Stock of and Call Options for the Common Stock of Santa Fe Intl. Corp., 817 F.2d 1018, 1020-21 (2d Cir. 1987) (approving this aspect of plan), cert. denied, 484 U.S. 1060 (1988).
B. “Expedient” Out of Pocket

The phrase “expedient” out of pocket measure is a term invented by the author of this article. The so-called “expedient” out of pocket measure accepts the “pure” out of pocket measure in principle. Nevertheless, to avoid the practical difficulty of determining the real value of the stock at the time of the plaintiff’s trade, the “expedient” out of pocket measure substitutes for this “true value” the market price after dissemination of the correct or previously nonpublic information.34


For discussion of Dura’s effect on the measurement of damages, see Nielsen & Prowse, supra note 25:

Dura has also given defendant experts additional ammunition . . . to attack “ins-and-outs” damages generated by [certain methods] of measuring [stock price] inflation. In addition . . . , the increased focus on linking alleged losses to corrective disclosures has focused attention and controversy over the way to implement many of the other steps involved in estimating per-share inflation, including the identification of alleged corrective disclosures, the measurement of the stock price movement and its statistical significance associated with the alleged corrective disclosures, and the parsing of the stock price movement when there is confounding information released simultaneously with the alleged corrective disclosures.

Id. at 19.

For discussion of Dura’s effect on certain price inflation models used to measure out of pocket damages and the adjustments to those models required in light of Dura, see David Tabak, Inflation and Damages in a Post-Dura World (Sept. 15, 2007), available at http://ssrn.com/abstract=1017334 (working paper).

For related discussion of “loss causation,” see supra notes 25, 26.

34 See Olazabal, supra note 26, at 360-61 (citing William K.S. Wang & Marc I. Steinberg, Insider Trading (1st ed. 1996)); Simplicity, supra note 25, at 1181-82 (citing William K.S. Wang & Marc I. Steinberg, Insider Trading (1st ed. 1996)); id. at 1191; Restitution, supra note 24, at 362 (“The court in some cases simply may accept the subsequent date as good evidence of what the stock was worth at the earlier time.”); see also Younger, supra note 15, at 20 (“A third view . . . values the security at a post-transaction date . . . such as the market reaction to the fraud . . . . This type of valuation can be described as a hybrid out-of-pocket measure of damages.”).

The Conference Report on the Private Securities Litigation Reform Act of 1995 described as “typical” the “expedient” out of pocket measure. See infra note 48 and accompanying text. The Conference Report, however, then notes a problem with this approach. See infra note 38.

For an example of a non-insider trading case adopting the expedient out of pocket measure, see Harris v. American Inv. Co., 523 F.2d 220, 226-27 (8th Cir. 1975) (using
In an insider trading case, one district court initially adopted the “pure” out of pocket measure of damages. Upon reconsideration, however, the judge used the “expedient” out of pocket measure. different terms, stating that if plaintiff could not demonstrate “expedient” out of pocket damages, he could attempt to demonstrate “pure” out of pocket measure damages. See id. at 227.), cert. denied, 432 U.S. 1054 (1976).

For another non-insider trading case that adopted a variant of the expedient out of pocket measure of damages, see In re Home Theater Sec. Litig., [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,576, at 97,851, 97,853-54 (C.D. Cal. 1997). The opinion rejected the defendant’s argument for the stock’s market price on the last day of trading on the market after disclosure of the adverse news. Instead, the court accepted the plaintiffs’ expert’s use of the average value “for five dates after the stock was delisted from NASDAQ.” Id. at 97,583. The opinion noted that the defendant had not presented any evidence that the stock’s closing price on the day after the disclosure accurately reflected the stock’s true value. See id. at 97, 584.

For an example of a non-insider-trading case that adopted the expedient out of pocket measure of damages for buyers who still retained their shares at the time the massive fraud was revealed to the market, see In re Crazy Eddie Sec. Litig., 948 F. Supp. 1154, 1165 (E.D.N.Y. 1997). The court adjusted the expedient out of pocket measure “to reflect that portion of the loss attributed to market and other factors.” Id. The court also allowed certain plaintiffs consequential damages in connection with their proxy context to gain control of the corporation as well as other expenses. See id. at 1166, 1173-74.

For a general discussion of the use of “reasonable time after public availability of accurate information” to measure out of pocket damages, see Aliken, supra note 15, § 14[c].

For discussion of a somewhat similar concept called “modified out of pocket” measure, see Restitution, supra note 24, at 361-65. Professor Thompson’s concept, however, combines my term “expedient” out of pocket measure with my concept of the cover measure. See id. at 363 n.54. Thompson also describes other rationales for modifying the out of pocket measure. See id. at 363-65.

When Congress created a civil penalty for stock market insider trading defendants, Congress defined “profit gained” or “loss avoided” of the defendant as “the difference between the purchase or sale price of the security and the value of that security as measured by the trading price of the security a reasonable time after public dissemination of the nonpublic information.” See Securities Exchange Act of 1934 § 21A(f), 15 U.S.C. § 78u-1(f) (2009). For discussion of the civil penalty provisions of § 21A, see WANG & STEINBERG, supra note 1, § 7:3.3.


See id. at 132-133. The circuit court opinion summarizes the district court’s revised holding. See Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 162, 168 n.25 (2d Cir. 1980). As the circuit court notes: “While the district court cited to Mitchell, its opinion makes clear that it was applying the out-of-pocket measure of damages.” Id. at 168 n.25. Actually, in this article’s terminology, the district court applied the “expedient” out of pocket measure.

On appeal, the Second Circuit (1) in the aggregate for all plaintiffs, adopted an overall recovery ceiling of the insider trading profit, and (2) apparently adopted the cover measure of damages, rather than either the pure or “expedient” out of pocket measures. See Elkind, 635 F.2d at 172-73; infra notes 64-65 and accompanying text.

Section 20A of the Securities Exchange Act creates an express private action for contemporaneous traders suing someone who violates the Exchange Act and its rules by
Although easier to apply than the “pure” out of pocket measure, the “expedient” out of pocket approach has its flaws. First, the inside information traded upon may be different from the later curative disclosure. In the words of one court: “One could not reasonably estimate how the public could have reacted to the news that the Titanic was near an iceberg from how it reacted to news that the ship had struck an iceberg and sunk.”37 Second, other factors, such as other company developments or overall stock market movements, may cause the post-disclosure stock price to differ from the price that would have prevailed at the time of the plaintiff’s trade with full accurate public disclosure.38

insider trading or tipping. See WANG & STEINBERG, supra note 1, §§ 4:8.3[B], 6:2. In this express action, the total damages for all contemporaneous traders are limited to the defendant’s “profit gained or loss avoided in the transaction or transactions that are the subject of the violation” (minus any amounts paid by the defendant in an equitable action for disgorgement brought by the Securities and Exchange Commission). Securities Exchange Act § 20A(b), 15 U.S.C. § 78t-1(b) (2009). See WANG & STEINBERG, supra note 1, §§ 4:8.3[B], 6:2.

In dictum, the Seventh Circuit has said that in § 20A insider trading cases: “Profit gained or loss avoided is a contemporaneous measure: the difference between the price the insider realizes and the market price of the securities after the news is released.” Short v. Bellevue Shoe Mfg. Co., 908 F.2d 1385, 1392 (7th Cir. 1990), cert. denied, 501 U.S. 1250 (1991).

In re MicroStrategy, Inc. Sec. Litig., 115 F. Supp. 2d 620, 664-65 (E.D. Va. 2000), endorsed the following measure of the defendant’s profit in a § 20A insider trading case: “Damages in an action under Section 20A are limited to the profits or losses avoided by the illegal transactions and are ordinarily measured by determining ‘the difference between the price the insider realizes and the market price of the securities after the news is released.’” Id. (quoting Short, 908 F.2d at 1392).

In dictum, McGhee v. Joutras, 1995 U.S. Dist. LEXIS 3542 (N.D. Ill. 1995), seemed to assume the appropriateness of looking to the price after curative disclosure when it stated:

Neither of those statements can be read as a holding as a matter of law that the next day’s market price always freezes the measure of damages in this type of lawsuit under Section 20A added to the Securities Exchange Act of 1934 (“1934 Act”) . . . . Instead the subject is clearly one for factual presentation and analysis.

Id. at *5 (footnote omitted).

In a case brought by the SEC seeking disgorgement of insider trading profits, a settlement plan for distribution of the disgorged proceeds allowed each public contemporaneous “stock seller to recover the difference between the price at which he sold and the price at the close of trading on the public disclosure date” less certain offsetting profits. SEC v. Wang, 944 F.2d 80, 86 (2d Cir. 1991) (affirming trial court’s approval of plan).

37 Elkind, 635 F.2d at 170; see Bad News, supra note 24, at 1454; Cornell & Morgan, supra note 27, at 890; Daniel R. Fischel, Use of Modern Finance Theory in Securities Fraud Cases, 38 BUS. LAW. 1, 19 (1982).

38 See In re Warner Commc’ns Sec. Litig., 618 F. Supp. 735, 744 (S.D.N.Y. 1985) (stating: Plaintiffs may argue that the ‘fair value’ of the stock should be drawn from its market price following revelation of the fraudulently withheld material . . . . Defendants will likely counter that the post-disclosure market price of the
stock has been affected by factors unrelated to the disclosure . . . . Indeed, defendants bear no responsibility for the impact of so-called nonactionable factors, such as general market conditions.

(citations omitted)); Bonime v. Doyle, 416 F. Supp. 1372, 1384 (S.D.N.Y. 1976) (“While this course has the obvious attraction of providing a concrete figure for the true worth of a security absent the fraud, it completely disregards the many other factors which influence price fluctuations over time of stocks in general or of a particular stock.”); Tucker v. Arthur Anderson & Co., 67 F.R.D. 468, 482 (S.D.N.Y. 1975); Nielsen & Prowse, supra note 25, at 22-23; Younger, supra note 15, at 20; see also Olazabal, supra note 26, at 361; cf. Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1342 (9th Cir. 1976) (Sneed, J., concurring in part and concurring in the result in part) (using different terminology than this article but objecting to measure of damages that opinion calls “rescissory” measure because “it permits a defrauded purchaser to place upon the defendant the burden of any decline in the value of the stock between the date of purchase and the date of disclosure of the fraud even though only a portion of that decline may have been proximately caused by the defendant’s wrong. The other portion is the result of market forces unrelated to the wrong.”).

The “Joint Explanatory Statement of the Committee of Conference” of the Private Securities Litigation Reform Act of 1995 made the following statement:

Typically, in an action involving a fraudulent misstatement or omission, the investor’s damages are presumed to be the difference between the price the investor paid for the security and the price of the security on the day the corrective information gets disseminated to the market.

Between the time a misrepresentation is made and the time the market receives corrected information, however, the price of the security may rise or fall for reasons unrelated to the alleged fraud. According to an analysis provided to the Senate Securities Subcommittee, on average, damages in securities litigation comprise approximately 27.7% of market loss.


This is one reason why Congress enacted § 21D(e) of the Securities Exchange Act of 1934, which limits damages established by reference to the market price of a security. This provision is reprinted infra in the text accompanying note 46.

In re Crazy Eddie Sec. Litig., 948 F. Supp. 1154, 1165 (E.D.N.Y. 1997), was a non-insider-trading case that adopted the expedient out of pocket measure of damages for buyers who still retained their shares at the time the massive fraud was revealed to the market. The court adjusted the damage amount for the portion of the price decrease due to “market and other factors.” Id. One factor was “the general decline of retail consumer electronic stock.” Id.

A possible complication is that curative disclosure may not take place at one time, but may gradually leak out through various sources, including the media. See Bad News, supra note 24, at 1454-55. For discussion of closure in securities class actions through leaked curative information, see WANG & STEINBERG, supra note 1, § 4:3.3[A]. For discussion of the possibility of curative disclosure by third parties and/or through leaks, see id. §§ 4:3.3[A], § 4:7.3 n.629, § 6:13.3 n.668 and accompanying text; cf. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 342 (2005) (discussing loss causation and stating: “if, say, the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss” (emphasis added)); Lormand v. US Unwired Inc., 565 F.3d 228, 261 (5th Cir. 2009) (“Thus, loss causation may be pleaded on the theory that the truth gradually emerged through a series of partial disclosures and that an entire series of partial disclosures caused the stock price deflation.”). Nevertheless, even if curative disclosure is gradual and by third parties and/or through leaks, at the time of full curative disclosure by the issuer, the price
A variant of the “expedient” out of pocket measure looks to the price change at curative dissemination and uses this change as the measure of damages to the plaintiff. The dollar amount of the price change at dissemination could be added or subtracted from the plaintiff’s transaction price to estimate the true value at the time of the plaintiff’s trade; alternatively, the percentage price change at dissemination could be applied to the plaintiff’s transaction price to estimate the true value at the time of the plaintiff’s transaction.39

should fully reflect the disclosed information. Cf. Fox, supra note 24, at 851 (“The efficient market hypothesis rules out any continuing inflation in price once there has been an unambiguous public announcement of the falsity of the misstatement.”).

Although not discussing damages, but rather “loss causation” and a subsequent resale, the Supreme Court’s following comments would also undermine looking to the price at curative disclosure to measure the amount of original inflation by a material misstatement or nondisclosure:

When the purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price. (The same is true in respect to a claim that a share’s higher price is lower than it would otherwise have been—a claim we do not consider here.) Other things being equal, the longer the time between purchase and sale, the more likely that this is so, i.e., the more likely that other factors caused the loss. Dura, 544 U.S. at 342-43. For discussion of intervening causes and “loss causation,” see Joel H. Bernstein & Ira A. Schochet, Loss Causation and the Global Economic Crisis, 41 SEC. REG. L. REP. (BNA) 1413 (July 27, 2009).

39 See Bad News, supra note 24, at 1433-34 (describing these two approaches plus possible third variant); Nielsen & Prowse, supra note 25, at 17-18 (also describing third approach); id. at 17 (“measure of inflation could conceivably be based on the dollar value of the stock price decline due to the corrective disclosure or the percentage decline due to the corrective disclosures”). See also Goldberg v. Household Bank, F.S.B., 890 F.2d 965, 966-67 (7th Cir. 1989) (Easterbrook, J.) (“When markets are liquid and respond quickly to news, the drop when the truth appears is a good measure of the value of the information, making it an appropriate measure of damages.”).

For a circuit court opinion inviting the trial judge to look at the percentage change at curative dissemination, see Sirota v. Solitron Devices, Inc., 673 F.2d 566, 577 (2d Cir.) (non-insider-trading case), cert. denied, 459 U.S. 838 (1982).

For discussion of the use of a “value line” (a variant of the price change at dissemination approach) to calculate the “true value” of the stock during the entire period of the fraud, see In re Oracle Sec. Litig., 829 F. Supp. 1176, 1180-82 (N.D. Cal. 1993) (non-insider-trading case citing other cases and authorities); Rosenbloom & Kroboth, supra note 27, at B13 (“A common method for computing price inflation [due to fraud] is to measure the price change after a curative disclosure and use this figure to represent inflation for every day of the class period.”).


For related discussion, see supra note 27.

Although discussing not damages, but “loss causation,” *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 344 (2005), states:

> Indeed, the Restatement of Torts, in setting forth the judicial consensus, says that a person who “misrepresents the financial condition of a corporation in order to sell its stock” becomes liable to a relying purchaser “for the loss” the purchaser sustains “when the facts ... become generally known” and “as a result” share value “depreciate[s].”

§ 548A, Comment b, at 107.

*Dura* also subsequently notes “[t]he complaint’s failure to claim that Dura’s share price fell significantly after the truth became known ...” *Id.* at 347.

Suppose the issuer makes curative disclosure, and the stock price does not change. Does this preclude a finding of “loss causation?” In *Dura*, the Supreme Court did not address this question. *See Dura*, 544 U.S. at 346 (“We need not, and do not, consider other proximate cause or loss-related questions.”); *cf. id.* at 343 (“The same is true in respect to a claim that a share’s higher price is lower than it otherwise would have been—a claim we do not consider here.”). For related discussion, see supra notes 26, 38; Kaufman, *supra* note 33, at 43 (stating *Dura* “rejects the harsh position ... that loss causation requires a showing that defendants made a corrective disclosure of the fraud followed by a causally related price drop”); Robert P. Varian & Richard L. Gallagher, *Loss Causation in Securities Class Actions After Dura*, 38 REV. SEC. & COMMODITIES REG. 241, 246 (2005) (“[P]hantom losses are losses purportedly caused by price inflation but not followed by any significant price decline, due to the existence of other market factors that prevent the price from falling significantly, or at all. In reversing the Ninth Circuit’s loss causation approach, the Supreme Court employed language that may prompt ambitious plaintiffs to seek recovery of such losses.”). *But cf.* Fry, *supra* note 33, at 74 (discussing whether “plaintiffs may be able to show a loss through a slow dissipation in the stock price such as when a misrepresentation has diminishing effect on the price of a stock over time so that no change in price occurs when a fraud is revealed”); *id.* at 75-76, 77 (discussing problems with this approach and concluding *Dura* likely precludes proof by this dissipation of price inflation method of proving loss).

For an argument against a flat finding of no “loss causation” in a scenario where the issuer makes curative disclosure and the stock price does not change, see Patrick J. Coughlin et al., *What’s Brewing in Dura v. Broudo? The Plaintiffs’ Attorneys Review the Supreme Court’s Opinion and Its Impact for Securities-Fraud Litigation*, 37 LOY. U. CHI. L.J. 1, 21-30 (2005); Fox, *supra* note 24, at 850-72, 874-75 (although conceding that bright line rule of “no loss” causation *might* be justified when price does not change after issuer curative disclosure and plaintiff has already reversed her transaction earlier); *cf.* Donald C. Langevoort, *Basic at
This alternative approach of looking at the price change at curative dissemination also has problems. In the words of one opinion, the drop after corrective disclosure was:

circumstantial evidence of the inflation when purchased, but it is not the exclusive method of measuring inflation. The fact finder may rely on other methods of determining actual value on the date of purchase. . . . [T]he drop after a corrective disclosure will not be conclusive of the amount of original inflation, both because the correction may be only partial . . . and because the prolonged nature of the fraud introduces other market variables which may affect the amount the market reacted to disclosures . . . .

Furthermore, the post-curative-disclosure stock price change may be due in part to other factors, such as general industry or stock market trends. In addition, by the time of full curative disclosure by the

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Twenty: Rethinking Fraud on the Market, 2009 Wis. L. Rev. 151, 184 (2009) (“Although this might well signal that the market was never fooled in the first place, it could also be explained by predisclosure leaks, independent discovery of the truth, or the mixing in of good news with the subsequent acknowledgement of the truth.”); Olazabal, supra note 26, at 362-68 (arguing that plaintiff who pays an inflated price because of defendant’s fraud may be harmed regardless whether plaintiff eventually sells at price higher or lower than original price).

40 Blackie v. Barrack, 524 F.2d 891, 909 n.25 (9th Cir. 1975) (non-insider-trading case), cert. denied, 429 U.S. 816 (1976); see James C. Spindler, Why Shareholders Want Their CEOs to Lie More After Dura Pharmaceuticals, 95 Geo. L.J. 653, 664 (2007) (“[A] particularly large and important drawback of the inductive ex post approach is that it assumes that circumstances have not changed, other than the revelation of the truth, between the time of the purchase decision and the price drop.” (footnote omitted)).

41 See In re Warner Commc’ns Sec. Litig., 618 F. Supp. 735, 744 (S.D.N.Y. 1985) (“[T]he degree to which the post-revelation decline is attributable to disclosure, and to what extent the decline was the result of nonactionable market and industry trends is difficult to ascertain.”); Bad News, supra note 24, at 1432 (“One cannot simply assume that the amount by which the stock price decreased following the announcement equals the per-share damages, however, because the stock price may have been affected by factors other than the securities violation.”).

For discussion of how finance theory might attempt to filter out the effect of the overall stock market movement on the individual stock’s price change at dissemination, see Bad News, supra note 24, at 1433-34; Fischel, supra note 37, at 17-19. For a description of the disparate results of expert testimony using finance theory, see Bad News, supra note 24, at 1425-26, 1456-57.

For discussion of event study methodology (a statistical technique that estimates the stock price impact of occurrences such as corporate announcements and disentangles this effect from information that affects stock prices marketwide), see RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 185-230 (2d ed. 1995); Allen, supra note 27; Esther Bruegger & Frederick C. Dunbar, Estimating Financial Fraud Damages with Response Coefficients, 35 J. Corp. L. 11 (2009); Frederick C. Dunbar & Arun Sen, Counterfactual Keys to Causation and Damages in Shareholder Class-Action Lawsuits,
issuer, the stock price may already have partially or fully adjusted because of insider trading, leaks by the issuer, or curative disclosure by various third party sources, including the media. In addition, the market may take time to digest fully the curative disclosure or may


For discussion of the use of both “event study” and “value line” methodology to calculate damages in securities fraud class actions, see Rethinking, supra note 24, at 1491-92; Eisenhofer et al., supra at 1424-28; Jeffrey M. Goldman, Avoiding Blurred Lines: The Computation of Damages in Rule 10b-5 Securities Class Actions Lawsuits in the Ninth Circuit and a Proposal for a More Sensible System, 2 HASTINGS BUS. L.J. 261, 265-74 (2006); Nielsen & Prowse, supra note 25, at 16-18, 21-22; id. at 20-21 (criticizing some variants of this methodology as incompatible with Dura); Scudder, supra note 24, at 447-51; Younger, supra note 15, at 21. For additional discussion of the “value line” approach, see supra note 39.

One article remarked:

Frequently, measurement of the difference between the price paid and the value of the security begins with the decline in the price of the security after disclosure of the facts that were misrepresented or omitted. Experts then duel over how much of that descent resulted from the disclosure of the “truth” and how much from other factors, such as general market declines or price declines in securities issued by companies similar to the defendant.

Fisher, supra note 25, at 55 (footnote omitted).

One commentator has noted still another problem with looking at the change in price at curative dissemination to calculate the true value of the stock at the time of the plaintiff’s trade. At the time of an announcement of bad news, investors may predict that litigation may follow and that the issuer will be forced to settle. This anticipation will accentuate the decline in stock price at the time of the announcement. See Bad News, supra note 24, at 1435-40. But see Dunbar & Sen, supra, at 234 (arguing that this prospect will have little impact on price because typical settlement has been small and insurance usually pays most of settlement and defendant’s legal expenses).

The problems of looking at the price change at curative disclosure are related to but not the same as the problems of looking at the price at curative disclosure. The latter problems are discussed supra at notes 37-38 and accompanying text.

42 See Fox, supra note 24, at 851-55; supra note 38 and sources cited therein.

While discussing loss causation, one commentator has stated: “[C]orrective disclosures can come from anyone–and importantly do not have to come from the company–to be considered revelations of the truth . . . . Revelations of the truth can also take the form of a series of disclosures instead of a single disclosing event.” Fry, supra note 33, at 66-67.

43 See Ferrell & Saha, supra note 33, at 175-78 (delayed reaction may be due to (1) inferring additional information about implications of the curative disclosure, (2) subsequent absence of additional bad news, or (3) additional details provided subsequently by issuer).

For an example of a case in which the plaintiff alleged a time lag between the corrective disclosure and the stock price decline, and the circuit court reversed the trial court’s dismissal
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initially overreact to the curative disclosure. Another possible difficulty is that, simultaneous with the curative disclosure, the issuer may disclose unrelated information.

Section 101(b) of the Private Securities Litigation Reform Act of 1995 added a new section 21D(e) to the Securities Exchange Act of 1934:

of the complaint based on failure adequately to plead loss causation, see In re Gilead Sciences Sec. Litig., 536 F.3d 1049. 1057-58 (9th Cir. 2008) (non-insider trading case).

44 See Ferrell & Saha, supra note 33, at 175; Torts, supra note 24, at 855.

With fraud by a company, another question is whether a stock price decline after revelation of the fraud in part reflects the corporation’s loss of credibility. See Langevoort, supra note 39, at 183 n.40; see also Dunbar & Sen, supra note 41, at 235. For an argument that plaintiffs should be able to recover damages resulting from declines in the stock price attributable to the market’s reassessment of the integrity of management or the company’s internal controls, see Barbara Black, Reputational Damages in Securities Litigation, 35 J. CORP. L. 169 (2009).

45 See Ferrell & Saha, supra note 33, at 168-69; Nielsen & Prowse, supra note 25, at 22-23; cf. Fener v. Operating Eng’rs Constr. Indus. & Misc. Pension Fund (Local 66), 579 F.3d 401, 406-11 (5th Cir. 2009) (refusing to certify plaintiff class of buyers because they failed to allege adequately causal link between drop in company’s stock price and revelation of defendant’s questionable circulation practices; although relevant press release caused stock price decline, release contained three separate pieces of information, only one piece corrected prior allegedly fraudulent statements; id. at 409 (quoting Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 266 (5th Cir. 2007)); Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 270 (5th Cir. 2007) (non-insider trading case; while denying class certification under the fraud on the market theory, stating: “when unrelated negative statements are announced contemporaneous of a corrective disclosure, the plaintiff must prove ‘that it is more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline’” (quoting Greenberg v. Crossroad Sys., Inc., 364 F.3d 657, 666 (5th Cir. 2004))); Spindler, supra note 40, at 687-89 (company may have other projects than one lied about; success or failure of these other projects also affects share price decline).

When the issuer makes curative disclosure at one point during the day and makes an unrelated announcement at a different time on the same day, one possible solution is to examine the intra-day stock price movement after the curative disclosure (that is, the price movement during the day). See Ferrell & Saha, supra note 33, at 168-69; Nielsen & Prowse, supra note 25, at 22 n.17.

With an affirmative misrepresentation by the issuer (as opposed to insider trading), still another approach to measuring damages is to look to the price change at the time of the issuer’s fraudulent statement. For discussion of such an approach to measure loss causation, see Ferrell & Saha, supra note 33, at 185-86; cf. Fox, supra note 24, at 852 (“The strongest alternative evidence [of loss causation] would be a showing that the misstatement itself, when initially made, was immediately followed by a significant price increase.”). But cf. Nielsen & Prowse, supra note 25, at 17 n.4 (“Early in the development of damages models, some damages experts would focus, not on the stock price impact when the allegedly corrective information was released to the market, but directly on the stock price impact of the alleged misrepresentations themselves to calculate [stock price] inflation. Over time this methodology declined in popularity mainly due to its inability to measure the stock price impact of alleged omissions by the company.”).
LIMITATION ON DAMAGES.—

(1) IN GENERAL.—Except as provided in paragraph (2), in any private action arising under this title in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

(2) EXCEPTION.—In any private action arising under this title in which the plaintiff seeks to establish damages by reference to the market price of a security, if the plaintiff sells or repurchases the subject security prior to the expiration of the 90-day period described in paragraph (1), the plaintiff’s damages shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the security and the mean trading price of the security during the period beginning immediately after dissemination of information correcting the misstatement or omission and ending on the date on which the plaintiff sells or repurchases the security.

(3) DEFINITION.—For purposes of this subsection, the “mean trading price” of a security shall be an average of the daily trading price of that security, determined as of the close of the market each day during the 90-day period referred to in paragraph (1).46

This provision sets a ceiling on any measure that “seeks to establish


The Private Securities Litigation Reform Act of 1995 also enacted certain provisions dealing with joint and several liability, proportionate fault, and settlement judgment reductions. For discussion of these provisions, see St. Eve & Pilz, supra note 15.
damages by reference to the market price of a security.\textsuperscript{47} By imposing this maximum, Congress implicitly recognized such measures of damages, including both the “expedient” out of pocket measure discussed above and the cover measure analyzed below in Part I(D).

Indeed, the “Joint Explanatory Statement of the Committee of Conference” described as “typical” the “expedient” out of pocket measure: “Typically, in any action involving a fraudulent misstatement or omission, the investor’s damages are presumed to be the difference between the price the investor paid for the security and the price of the security on the day the corrective information gets disseminated to the market.”\textsuperscript{48}

\textbf{C. Rescissory}

In some circumstances, the courts adopt rescissory damages as the measure.\textsuperscript{49} This measure attempts to undo the fraudulent transaction and

\textsuperscript{47} For the language of the provision, see \textit{supra} text accompanying note 46.
\textsuperscript{49} See \textit{Ambassador Hotel Co., Ltd. v. Wei-Chuan Inv.}, 189 F.3d 1017, 1031 (9th Cir. 1999) (“If true rescission is no longer possible (perhaps because the plaintiff no longer owns the subject of the sale), the court may order its monetary equivalent.”); \textit{id.} at 1030 (“The district court may apply a rescissory measure of damages in appropriate circumstances.” (citing \textit{DCD Programs, Ltd. and Blackie})); \textit{DCD Programs, Ltd. v. Leighton}, 90 F.3d 1442, 1447 (9th Cir. 1996); \textit{Arthur Young & Co. v. Reves}, 937 F.2d 1310, 1336 (8th Cir. 1991) (“We believe that rescissory damages are best suited to the harm and to the facts of this case.”), \textit{aff’d on other grounds}, 507 U.S. 179 (1993); \textit{Jordan v. Duff and Phelps}, Inc., 815 F.2d 429, 441-42 (7th Cir. 1987) (stating in dictum that there are two standard measures of damages in securities law and that one is “rescissionary” measure), \textit{cert. denied}, 485 U.S. 901 (1988); \textit{In re Letterman Bros. Energy Sec. Litig.}, 799 F.2d 967, 972-73 (5th Cir. 1986) (mentioning “rescissional measure” but finding it inappropriate in that case), \textit{cert. denied}, 480 U.S. 918 (1987); \textit{Blackie v. Barrack}, 524 F.2d 891, 909 (9th Cir. 1975) (“While 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.”), \textit{cert. denied}, 429 U.S. 816 (1976); \textit{Glick v. Campagna}, 613 F.2d 31, 37 (3d Cir. 1979) (“[i]f the defendant no longer owns the stock or it is otherwise unavailable because of a merger or other intervening event, then the court may award rescissory damages to place the plaintiff in the same financial position he would have been were it possible to return the stock.”) (dictum); \textit{Myzel v. Fields}, 386 F.2d 718, 742 (8th Cir. 1967) (“[W]here this [rescission] is impossible because of the disposal or retirement of the stock, then equivalent value of the stock at the time of resale . . . or at the time of judgment . . . should be the proper measure of damage.”), \textit{cert. denied}, 390 U.S. 951 (1968); \textit{Kronfield v. Advest, Inc.}, 675 F. Supp. 1449, 1455-56 (S.D.N.Y. 1987) (court may award rescissory damages when out of pocket damages are zero and gravamen of the action is not whether plaintiff purchased at fair price but that plaintiff bought at all); \textit{cf. Randall v. Loftsgaarden}, 478 U.S. 647, 662 (1986) (“We shall therefore assume, arguendo, that a rescissory recovery may sometimes be proper on a § 10(b) claim, and that this is such a case.”); \textit{Gottlieb v. Sandia
return the defrauded party to her position before the fraudulent inducement to enter into the trade.  In other words, rescissory damages award a plaintiff the dollar amount at the time of judgment necessary to put her back in her original position prior to the fraudulent transaction. The rescissory measure implicitly presumes that the plaintiff would not have traded but for the defendant’s fraud.

Courts usually require the plaintiff to prove a contractual relationship with the defendant. Most stock market insider trading plaintiffs are not in contractual privity with the defendant. Therefore, this measure of damages would not be appropriate for those plaintiffs. Arguably, this measure would give such plaintiffs a “free ride” to gain speculative profits from stock price changes until the date of judgment without risking any money.

Am. Corp., 304 F. Supp. 980, 990 (E.D. Pa. 1969) (“[I]f the actual stock or assets which were originally traded are no longer available, damages will be awarded in the amount of the difference between the present market value of the consideration originally given and the consideration received.”) (dictum), aff’d in part, rev’d in part, 452 F.2d 510 (3d Cir.), cert. denied, 404 U.S. 938 (1971). But cf. Randall, 478 U.S. at 661 (“[W]hether and under what circumstances . . . a rescissory measure . . . is available . . . is . . . unsettled.”)

For related discussion of rescissory damages, see WANG & STEINBERG, supra note 1, § 4:9.1, at 4-246 n.747. See also WANG & STEINBERG, supra note 1, § 4:9.2 (dictum).

For discussion of Randall’s treatment of damages, see Lowenfels & Bromberg, supra note 15, at 1089-92.

50 See Robertson v. White, 81 F.3d 752, 756 (8th Cir. 1996) (“Rescissory damages serve to place the Class in the same position they would have been but for [defendant’s] fraud.” (citing Arthur Young & Co.)); Arthur Young & Co. v. Reves, 937 F.2d 1310, 1337 (8th Cir. 1991) (“Rescissory damages place a plaintiff in the same position she would have been in had she not been induced to enter into the transaction.”), aff’d on other grounds, 507 U.S. 179 (1993); Burch, supra note 23, at 366; cf. Huddleston v. Herman & MacLean, 640 F.2d 534, 554 (5th Cir. 1981) (describing “rescissional” measure adopted by trial court), modified on other grounds, 459 U.S. 375 (1983); Michael J. Kaufman, No Foul, No Harm: The Real Measure of Damages Under Rule 10b-5, 39 CATH. U. L. REV. 29, 101 (1989) (discussing Fifth Circuit Huddleston opinion). But see Jordan v. Duff and Phelps, Inc., 815 F.2d 429, 441-42 (7th Cir. 1987) (“[T]he ‘rescissionary’ measure of damages is based on the defendant’s gain. The court reverses the transaction and compels defendants to return the purchase price or disgorges any gains they received.”) (dictum), cert. denied, 485 U.S. 901 (1988).

51 See Huddleston, 640 F.2d at 554 (“Use of the rescissional measure is usually limited to cases involving either privity between plaintiff and defendant or some specific fiduciary duty owed by brokers to their customers.”); Kaufman, supra note 50, at 101-02 (discussing Huddleston); see also Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1341-44 (9th Cir. 1976) (Sneed, J., concurring in part and concurring in result in part) (rescissory measure of damages is not appropriate in case where plaintiffs purchased in open market and did not deal face to face with corporate defendant). But cf. Blackie v. Barrack, 524 F.2d 891, 909 (9th Cir. 1975) (in class action against issuer for misrepresentations, stating “it is within the discretion of the district judge in appropriate circumstances to apply a rescissory measure”), cert. denied, 429 U.S. 816 (1976). For additional discussion of the rescissory measure of damages, see WANG & STEINBERG, supra note 1, §§ 4:9.1, 4:9.2, 4:9.4.

52 See WANG & STEINBERG, supra note 1, ch. 6, especially §§ 6:1, 6:2, 6:3, 6:4, 6:8, 6:9, 6:10.
On the other hand, a plaintiff on the opposite side of an insider trade might be entitled to rescissory damages. The remedy of rescission should be available to such a party in privity who successfully sues an insider trading defendant under the classical relationship theory. It is unclear whether rescission is available against a misappropriator. Also uncertain is whether Exchange Act section 20A itself creates a statutory cause of action for rescission by the party on the other side of the insider trade.

If rescission is available to a plaintiff against an insider trading defendant, rescissory damages may be an alternative remedy, especially if rescission is no longer feasible. Indeed, courts might view such damages as a variant of rescission rather than money damages.

Trades of large blocks of stock have some aspects of face-to-face trades. If a plaintiff purchases a large block from an insider trader, a court might sometimes be willing to grant rescissory damages.

D. Cover

The cover measure implicitly presumes that the plaintiff would not have traded but-for the defendant’s fraud. This approach also implicitly assumes that the plaintiff is entitled to a rescissory measure of damages. Nevertheless, this approach imposes on the plaintiff the obligation to mitigate damages by reversing her trade within a “reasonable” time after curative disclosure.

The main case adopting this measure is *Mitchell v. Texas Gulf Sulphur Co.*, a suit based on an issuer’s misleading press release. The court stated:

53 See WANG & STEINBERG, supra note 1, §§ 4:9.1, 4.9.2.
54 See id. § 4:9.3.
55 See id. § 4:9.4.
56 See id. § 4:9.1, at 4-246 n.747.

For discussion of the rescissory measure, see supra Part I.C.

For an earlier circuit case adopting a cover-like measure of damages (in affirmative
We believe the measure of damages used should award the reasonable investor the amount it would have taken him to invest in the . . . market within a reasonable period of time after he became informed of the April 16 release [corrective disclosure] . . . . The damages then should be based on the highest value of TGS stock between Monday, April 20 and a reasonable time thereafter. Whether we conclude such duration should be an added nine trading days (through Friday, May 1) which seems more reasonable in these circumstances, or the seventeen additional trading days imposed by the trial court (through Wednesday, May 13) is irrelevant to the award. For in either event, the highest value was achieved on Wednesday, April 29 (at $59) prior to the expiration of either time limit.\footnote{Id. at 105.}

In a case involving an insider trading defendant, dictum in an en banc misrepresentation/nondisclosure fact situation), see Baumel v. Rosen, 412 F.2d 571, 575-76 (4th Cir. 1969) (plaintiff bought stock when corporation was closely held; damages measured when stock was first publicly traded without attached debentures (citing Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968)), cert. denied, 396 U.S. 1037 (1970); see also Foster v. Fin. Tech. Inc., 517 F.2d 1068, 1072 (9th Cir. 1975) (non-insider-trading case; denying consequential damages because: “As in all 10b-5 cases, their damages are limited by what they would have realized if they had acted upon their claim [which they settled in exchange for securities] when they first learned of the fraud or had reason to know of it.”); id. (“[W]here a reasonable man . . . would have taken action to protect himself . . . the chain of causation is cut and plaintiff cannot recover damages for subsequent losses.”). For a district court opinion adopting a cover-like measure, see American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 764-66 (E.D. Va. 1980) (affirmative misrepresentation/nondisclosure in face to face transaction).\footnote{446 F.2d at 92-93, 96-102.}

\footnote{Id. at 105. For discussion of the cover measure and Mitchell, see Younger, supra note 15, at 22.}

Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 651 F.2d 615 (9th Cir. 1981), dealt with § 10(b)/Rule 10b-5 violations by a stockbroker who misrepresented the risks of using margin and of purchasing certain stocks. The court affirmed the trial court’s calculation of damages based on the plaintiffs’ imputed sale of their stock when they knew of the fraud. \footnote{Id. at 621; see also Nye v. Blyth, Eastman, Dillon & Co., 588 F.2d 1189, 1198-1200 (8th Cir. 1978) (applying somewhat similar approach to damages in another case involving stockbroker misrepresentation to customer).}


For discussion of a cover-like measure of damages under the Commodities Exchange Act and citations of cases under various bodies of law adopting a cover-like measure of damages (including Mitchell), see Schultz v. Commodities Futures Trading Comm’n, 716 F.2d 136, 140-41 (2d Cir. 1983).
First Circuit opinion endorsed the cover measure when the plaintiff buys or sells publicly traded securities.\textsuperscript{62} Citing, inter alia, \textit{Mitchell}, the court stated that “when a seller of publicly traded securities has learned of previously undisclosed material facts, and decides nevertheless not to replace the sold securities, he cannot later claim that his failure to obtain subsequent stock appreciation was a proximate consequence of his prior ignorance.”\textsuperscript{63}

The Second Circuit in the insider trading case of \textit{Elkind} also apparently adopted the cover measure, but in conjunction with an overall recovery ceiling of the insider trading profit.\textsuperscript{64}

(1) to allow any uninformed investor, where a reasonable investor would either have delayed his purchase or not purchased at all if he had had the benefit of the tipped information, to recover any post-purchase decline in market value of his shares \textit{up to a reasonable time after he learns of the tipped information or after there is public disclosure of it} but (2) limit his recovery to the amount gained by the tippee as a result of his selling at the earlier date rather than delaying his sale until the parties could trade on equal informational basis.\textsuperscript{65}

(Part I(B) above reprinted section 21D(e) of the Securities Exchange Act of 1934.\textsuperscript{66}) That provision sets a ceiling on any measure that “seeks to establish damages by reference to the market price of a security.”\textsuperscript{67} The maximum is based on “the mean trading price of that security during the 90-day period beginning on the date [of dissemination].”\textsuperscript{68} Courts awarding the cover measure could not exceed this ceiling. Nevertheless, by imposing this limitation, Congress implicitly recognized measures of damages based on the market price of the security, including the cover measure.

\textsuperscript{62} See SEC v. MacDonald, 699 F.2d 47, 48, 53-54 (1st Cir. 1983) (en banc) (dictum).
\textsuperscript{63} \textit{Id.} at 53 (dictum). For additional discussion of \textit{MacDonald} and the measure of the defendant’s profits when the SEC seeks disgorgement, see \textsc{Wang} \& \textsc{Steinberg}, supra note 1, § 7:3.2.
\textsuperscript{64} See \textit{Elkind} v. Liggett & Myers, Inc., 635 F.2d 156, 172-73 (2d Cir. 1980). For discussion of the \textit{Elkind} ceiling, see \textit{supra} note 36; \textsc{Wang} \& \textsc{Steinberg}, supra note 1, § 4:8.3[B].
\textsuperscript{65} \textit{Elkind}, 635 F.2d at 172 (emphasis added). Confusingly, the opinion earlier states that it need not pass on the modified rescissionary cover measure of \textit{Mitchell}. \textit{Id.} at 168 n.25. Nevertheless, the court seems to endorse that measure, at least in conjunction with the overall ceiling of the insider trading profit.
\textsuperscript{66} See \textit{supra} text accompanying note 46.
\textsuperscript{67} \textit{Id.}
\textsuperscript{68} \textit{Id.}
E. Distinction Between the “Expeditious” Out of Pocket and Cover Measures

This article earlier discussed the revised trial court opinion in the insider trading case of Elkind. Although it cited Mitchell, it actually adopted the “expedient” out of pocket measure. This decision blurred the distinction between the cover and “expedient” out of pocket measures.

Although the “expedient” out of pocket and cover measures have some surface similarities, they are different. The “expedient” out of pocket measure, like the “pure” out of pocket measure, assumes that the plaintiff would have traded at the same time anyway even without the fraud, but at a more attractive price. Nevertheless, to avoid the practical difficulty of ascertaining this hypothetical better price, the “expedient” out of pocket measure either substitutes the price reached after curative dissemination or looks at the (dollar or percentage) price change at dissemination (possibly with some adjustment). In contrast, the cover measure seems to assume implicitly that the plaintiff would not have traded absent the fraud, but imposes on the plaintiff a duty to mitigate her losses by reversing her transaction within a reasonable time after curative disclosure.

The “expedient” out of pocket measure is likely to use an earlier date than the cover measure. Market-makers and institutional investors obviously learn news and respond sooner than smaller investors. Because of the quick reaction of market-makers and institutional investors, the market price may adjust fairly quickly to an announcement. Thus, the “expedient” out of pocket measure is likely to use an earlier date than the cover measure.

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69 See supra notes 35-36 and accompanying text.
71 As the circuit court in Elkind noted: “While the district court cited to Mitchell, its opinion makes clear that it was applying the out-of-pocket measure of damages.” 635 F.2d at 168 n.25. Actually, in this article’s terminology, the district court applied the “expedient” out of pocket measure.

Below is an example of the trial court’s blurring of the cover and “expedient” out of pocket measures:

Mitchell, supra, has been criticized for using the standard of the time it would take a reasonable investor, rather than the market, to absorb the information disclosed . . . . Under the facts of the instant case, the court does not find this distinction significant . . . . [T]he court finds that eight trading days is sufficient time to allow the market or a reasonable investor to become apprised of the new information.

Elkind, 472 F. Supp. at 133 (emphasis added).
pocket measure may select a date soon after news is public.

In contrast, the cover measure is likely to use a later date than the “expedient” out of pocket measure. Investors vary greatly in their reaction times to a news announcement.\(^{74}\) When applying the cover measure to a class of plaintiffs that includes smaller investors, a court is likely to select a later deadline to mitigate losses. After all, these ordinary investors must find out about the announcement, absorb it, overcome any reluctance to realize “paper” losses, and raise additional funds to reverse their transactions.\(^{75}\)

Finally, the cover measure always looks at a stock price (at a time after curative disclosure). In contrast, the expedient out of pocket measure sometimes looks at a stock price and sometimes a stock price change (after curative disclosure).

\(\textbf{F. Disgorgement of Windfall Profits}\)

Sometimes, despite the literal “actual damages” limit of Exchange Act section 28(a),\(^{76}\) the plaintiff may recover the defendant’s windfall profits generated subsequent to curative disclosure.\(^{77}\) Such recoveries have usually

How quickly the market price reflects a news announcement depends on the extent to which the stock market is efficient. For discussion of whether the stock market is efficient, see WANG & STEINBERG, supra note 1, §§ 2.2.2 & n.31, 3.3.7 & n.103. For discussion of some factors that might determine whether a security trades in an “efficient market,” see id. § 4.7.3.

\(^{72}\) See Nye v. Blyth, Eastman, Dillon & Co., 588 F.2d 1189, 1198 (8th Cir. 1978) (“Obviously, the reasonable time period will vary with the circumstances.”; awarding damages somewhat like cover in case involving stockbroker misrepresentation to a customer); see also Leas, supra note 58, at 379 (“The reduction of the investor population to a single standard seems particularly unrealistic.”); cf. American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 765 n.79 (E.D. Va. 1980) (finding that reasonable time to cover is two weeks in case awarding cover-like measure; court considered number of factors, including sophistication of corporate plaintiff and large size of block sold—10% of another company).

\(^{75}\) For discussion of some of the difficulties encountered by the ordinary investor in covering his or her loss, see Chesnutt, supra note 59, at 1148; see also Leas, supra note 58, at 380 (discussing problems of “long term” investors in covering); cf. Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 105 (10th Cir. 1971) (quoted supra at note 61; corrective disclosure was on April 16; court based cover damages on highest price reached between Monday, April 20, and either Friday, May 1 or Wednesday, May 13; highest price was same during either time range), cert. denied, 404 U.S. 1004 (1971).

\(^{76}\) 15 U.S.C. § 78bb(a) (2009). For the pertinent language of § 28(a), see supra note 18. For additional discussion of Exchange Act § 28(a), see supra notes 16-22 and accompanying text.

\(^{77}\) See Randall v. Loftsgaarden, 478 U.S. 647, 663 (1986) (dictum) (citing and quoting Ute and stating that Exchange Act § 28(a) does not impose “a rigid requirement that every recovery . . . must be limited to the net economic harm suffered by the plaintiff”); Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972) (“[J]nder § 28 of the Act . . . where the defendant received more than the seller’s actual loss . . . damages are the amount of defendant’s profit”) (dictum). For discussion of Randall’s treatment of damages, see Lowenfels & Bromberg, supra note 15, at 1089-92. For discussion of the disgorgement of windfall profits under Rule 10b-5, see id. at 1098-1102; Burch, supra note 23, at 365-66.
occurred in the close corporation context. 78 Janigan v. Taylor 79 held that “[i]t is more appropriate to give the defrauded party the benefit, even of windfalls, than to let the fraudulent party keep them,” 80 thereby focusing on the deterrence rationale. 81 This measure is usually applied when the plaintiff sells shares that greatly increase in value after the sale, if the plaintiff can prove

One court has linked the disgorgement of windfall profits and the rescissory measures. See Jordan v. Duff and Phelps, Inc., 815 F.2d 429, 441-42 (7th Cir. 1987) (stating in dictum: “the ‘rescissionary’ measure of damages is based on the defendant’s gain. The court reverses the transaction and compels defendants to return the purchase price or disgorge any gains they received”), cert. denied, 485 U.S. 901 (1988). Similarly, Rowe v. Maremont Corp., 850 F.2d 1226, 1241 (7th Cir. 1988), mentioned that disgorgement avoids unjust enrichment of the defendant, but also emphasized that “disgorgement is meant to place a defrauded seller in the same position he would have occupied had the buyer’s fraud not induced him to enter the transaction.”

Nevertheless, this article assumes that the disgorgement measure focuses on the defendant’s gain, while the rescissory measure focuses on the plaintiff’s loss. The rescissory measure assumes that the defendant would not have traded but for the defendant’s fraud and seeks to restore the plaintiff to her original position. See supra Part I.C.

The disgorgement of an insider trading defendant’s windfall profits generated subsequent to curative disclosure is different from the disgorgement of defendant’s profits resulting directly from the trade made on material nonpublic information. The latter ceiling on recovery was endorsed first by the Second Circuit in an implied cause of action against an insider trading defendant (see supra note 36; notes 64-65 and accompanying text; WANG & STEINBERG, supra note 1, § 4.8.3[B]) and then by Congress in its express cause of action against insider trading defendants (see supra note 36; WANG & STEINBERG, supra note 1, § 4.8.3[A]).

78 See Pidcock v. Sunnyland Am., Inc., 854 F.2d 443 (11th Cir. 1988); Rochez Bros., Inc. v Rhoades, 491 F.2d 402, 405, 411-13 (3d Cir. 1974); Janigan v. Taylor, 344 F.2d 781, 783, 786-87 (1st Cir.), cert. denied, 382 U.S. 879 (1965); see also Siebel v. Scott, 725 F.2d 995, 997, 1001-02 (5th Cir.) (plaintiffs sold their limited partnership interests; plaintiffs were 7 out of 11 limited partners), cert. denied, 467 U.S. 1242 (1984); cf. Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972) (dictum in face to face transaction of closely held corporation shares); Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 105 (10th Cir.) (“Restitution and damages equivalent to restitution are inappropriate remedies in this action. Traditionally these theories have been concerned with direct-personal dealings in which there is privity and/or unjust enrichment upon which to justify the remedy.” (citing, inter alia, Janigan) (emphasis added), cert. denied, 404 U.S. 1004 (1971); Myzel v. Fields, 386 F.2d 718, 726, 747-49 (8th Cir. 1967) (close corporation; Janigan measure is one jury could award), cert. denied, 390 U.S. 951 (1968).

79 344 F.2d 781 (1st Cir. 1965), cert. denied, 382 U.S. 879 (1965).
80 Id. at 786; cf. Pittsburgh Terminal Corp. v. Baltimore & O.R.R., 824 F.2d 249, 255 (3d Cir. 1987) (“Where there is a possibility that one or the other party in a securities action will receive a windfall, the victim is favored over the violator.” (citing Rochez Bros. v. Rhoades, 491 F.2d 402, 415 (3d Cir. 1974), which in turn quotes Janigan.

Randall v. Loftsgaarden, 478 U.S. 647, 663 (1986), first quoted Ute and then quoted Janigan to explain the rationale for forcing the defendant to disgorge his or her profits.

81 See Nelson v. Serwold, 576 F.2d 1332, 1339 (9th Cir.) (“To allow violators of the Act to profit by their misconduct would undermine the deterrence that the Act was intended to effect.”), cert. denied, 439 U.S. 970 (1978).
that the defendant acquired the stock by fraud.\textsuperscript{82}

The same judge who wrote \textit{Janigan} later authored the \textit{en banc} First Circuit opinion of \textit{SEC v. MacDonald},\textsuperscript{83}\textsuperscript{84} involving a defendant guilty of stock market insider trading.\textsuperscript{84} In dictum, \textit{MacDonald} stated that \textit{Janigan} does not apply to publicly traded securities.\textsuperscript{85} (Citing, \textit{inter alia}, \textit{Mitchell}, \textit{MacDonald} in dictum apparently endorsed the cover measure when a plaintiff buys or sells a publicly traded security.)\textsuperscript{86} After the plaintiff has the reasonable opportunity to reverse the transaction, she should do so and thus protect herself from further damage. If she does not, she should suffer the consequences.\textsuperscript{87}

Because the disgorgement of windfall profits measure seems confined to the close corporation situation,\textsuperscript{88} the measure would not apply to stock market insider trading.

\textbf{G. Benefit of the Bargain}

The courts also sometimes employ the benefit of the bargain measure in section 10(b) cases.\textsuperscript{89} This measure is the difference between what the

\textsuperscript{82} See \textit{Kaufman}, supra note 50, at 43.


\textsuperscript{84} \textit{699 F.2d 47} (1st Cir. 1983) (\textit{en banc}).

\textsuperscript{85} \textit{See id.} at 48.

\textsuperscript{86} \textit{See id.} at 53 (dictum).

\textsuperscript{87} \textit{See id.} at 53-54. For discussion of the cover measure and \textit{MacDonald}'s endorsement of the cover measure in dictum, see supra Part I.D.

\textsuperscript{88} \textit{See MacDonald}, \textit{699 F.2d} at 53.

\textsuperscript{89} \textit{See supra} notes 78, 85 and accompanying text.
plaintiff actually received and what she expected she would receive had the defendant’s representations been true. Unlike the out of pocket measure, which focuses on the plaintiff’s actual loss, the benefit of the bargain measure focuses on the potential gain had the misrepresentation been true. Due to its arguably speculative nature, the benefit of the bargain measure is applied by the courts less often than the out of pocket measure. The courts generally limit the measure’s application to unusual circumstances such as certain tender offer misrepresentations and cases in which such damages can be assessed with “reasonable certainty.”


See DCD Programs, Ltd. v. Leighton, 90 F.3d 1442, 1449 (9th Cir. 1996) (citing Cunha v. Ward Foods, Inc., 804 F.2d 1418, 1426 (9th Cir. 1986)).

For discussion of the difference between the benefit of the bargain and out of pocket measures, see Ronald B. Lee, Comment, The Measure of Damages Under Section 10(b) and Rule 10b-5, 46 Md. L. Rev. 1266, 1274 (1987).

See Neesemann, supra note 89, at 90.

See Osofsky v. Zipf, 645 F.2d 107, 114 (2d Cir. 1981) (“We believe that the benefit-of-the-bargain rule should be applied under the 1934 Act to the limited situation involved in this case, where misrepresentation is made in the tender offer and proxy solicitation materials as to the consideration to be forthcoming upon an intended merger.”). See also 5E ARNOLD S. JACOBS, DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 20:10, at 20-66 to 20-67 (2008) (stating that some Rule 10b-5 opinions hold that benefit of bargain theory is never appropriate but listing seven situations in which courts have awarded such damages, including misrepresentations in tender offer); cf. McMahan & Co. v. Wherehouse Entm’t Inc., 65 F.3d 1044, 1049 (2d Cir. 1995) (“We held that benefit-of-the-bargain damages, under Rule 10b-5, were particularly appropriate in the context of tender offers.” (citing Osofsky)).

See McMahan & Co. v. Wherehouse Entm’t Inc., 65 F.3d 1044, 1049-50 (2d Cir. 1995) (“[T]he key to awarding benefit-of-the-bargain damages is the degree of certainty to which they can be established.” Id. at 1049 (citing Osofsky); court did not decide whether plaintiffs could establish benefit of the bargain damages with requisite degree of certainty); Commercial Union Assurance Co. plc v. Milken, 17 F.3d 608, 614 (2d Cir.) (“Benefit-of-the-bargain damages in a Rule 10b-5 action are not available unless they can be calculated with
Some courts have rejected this measure. One rationale is that such recovery would be contrary to Exchange Act section 28(a), which provides in pertinent part that “no person permitted to maintain a suit for damages under the provisions of this title shall recover . . . a total amount in excess of his actual damages on account of the act complained of.”

Stock market insider trading typically involves no misrepresentation. For this reason, among others, benefit of the bargain damages would not be appropriate in an insider trading case.

reasonable certainty.”), cert. denied, 513 U.S. 873 (1994); Barrows v. Forest Labs, Inc., 742 F.2d 54, 59-60 (2d Cir. 1984); Ososky v. Zipf, 645 F.2d 107, 112, 114 (2d Cir. 1981) (“But, of course, giving the plaintiff benefit-of-the-bargain damages is appropriate only where they can be established with reasonable certainty.” Id. at 114); Younger, supra note 15, at 21 (“The federal courts have generally rejected this measure of damages as highly speculative. But more recently this theory has been allowed as a basis for damages when a reasonable certainty test can be met.” (footnote omitted)).

Preventing unjust enrichment may be another factor justifying use of the benefit of the bargain measure. See Hackbart v. Holmes, 675 F.2d 1114, 1121-22 (10th Cir. 1982) (affirming trial court’s damages award, which defendant argued was improper “benefit of the bargain” measure; circuit court said trial court’s measure could be justified either as out of pocket measure or as means of avoiding unjust enrichment of defendant); id. at 1122 (“Preventing unjust enrichment is a well-recognized exception to the rule limiting damages to out-of-pocket loss.”).

96 See Astor Chauffeured Limousine Co. v. Rumfield Inv. Corp., 910 F.2d 1540, 1551-52 (7th Cir. 1990) (citing other cases); Madigan, Inc. v. Goodman, 498 F.2d 233, 239-40 (7th Cir. 1974); Levine v. Seilon, Inc., 439 F.2d 328, 334 (2d Cir. 1971) (“a defrauded buyer of securities is . . . not [entitled to] the difference between the value of what he got and what it was represented he would be getting”); Restitution, supra note 24, at 359-60; cf. Barrows v. Forrest Lab., Inc., 742 F.2d 54, 59-60 (2d Cir. 1984) (distinguishing Ososky).

97 See Astor Chauffeured Limousine Co. v. Rumfield Inv. Corp., 910 F.2d 1540, 1551-52 (7th Cir. 1990) (“[T]he statutes limit victims to ‘actual damage’, which the courts routinely understand to mean ‘out of pocket loss’ . . . . ‘Out of pocket’ loss does not include lost profits.” (citations omitted)); Neeseann, supra note 89, at 91; cf. Estate Counseling Serv., Inc. v. Merrill Lynch Pierce, Fenner & Smith, Inc., 303 F.2d 527, 533 (10th Cir. 1962) (“The Act permits recovery of ‘his actual damages . . . .’ ‘Actual damages,’ . . . is the ‘out of pocket rule.’ . . . [L]iability does not include the expectant fruits of an unrealized speculation.”). Contra Wherehouse, 65 F.3d at 1049; but cf. Randall v. Loftsgaarden, 478 U.S. 647, 663 (1986) (“[T]his court has never interpreted § 28(a) as imposing a rigid requirement that every recovery on an express or implied right of action under the 1934 Act must be limited to the net economic harm suffered by the plaintiff.”).


II. SUMMARY AND CONCLUSION: THE DIFFICULTY OF DETERMINING A “FAIR” MEASURE OF DAMAGES

This article has discussed various measures of the damages of a private plaintiff who sues a stock market insider trading defendant. The measures are: “pure” out of pocket, “expedient” out of pocket, rescissory, and cover.

The “pure” out of pocket measure is the difference between the transaction price and the real or actual share value. Implicitly, this measure assumes that but-for the defendant’s fraud, the plaintiff would have traded at the same time anyway, but at a better price.

The so-called “expedient” out of pocket measure accepts the “pure” out of pocket measure in principle. Nevertheless, to avoid the practical difficulty of determining the real value of the stock at the time of the plaintiff’s trade, the “expedient” out of pocket measure substitutes for this “true value” the market price after dissemination of the correct or previously nonpublic information. A variant of the “expedient” out of pocket measure looks to either the dollar or percentage price change at curative dissemination and use this change as a measure of the damages to the plaintiff. The price change at dissemination could be applied to the plaintiff’s transaction price to estimate the true value at the time of the plaintiff’s trade. To correct for the effects of extraneous factors, more complex variations exist.

The rescissory measure attempts to undo the fraudulent transaction and return the defrauded party to her position before the fraudulent inducement to enter into the trade. In other words, rescissory damages award a plaintiff the dollar amount at the time of judgment necessary to put her back in her original position prior to the fraudulent transaction. This measure implicitly assumes that the plaintiff would not have traded but-for the defendant’s fraud.

For the rescissory measure, courts usually require the plaintiff to prove a contractual relationship with the defendant. Most stock market insider trading plaintiffs are not in contractual privity with the defendant. The rescissory measure would give such plaintiffs an unjustified “free ride” to gain speculative profits from stock price changes until the date of judgment without risking any money. Conceivably, however, rescissory damages might be available to a plaintiff in contractual privity with an insider trading defendant, especially one liable under the classical relationship theory.

Like the rescissory measure, the cover measure implicitly presumes that the plaintiff would not have traded but-for the defendant’s fraud. This approach also implicitly assumes that the plaintiff is entitled to a rescissory measure of damages. Nevertheless, the cover measure imposes on the plaintiff the obligation to mitigate damages by reversing her trade within a “reasonable” time after curative disclosure.

Although this article briefly discussed two additional damage measures, “disgorgement of windfall profits” and “benefit of the bargain,”
these two measures are not appropriate in stock market insider trading cases.

To select a “fair” measure of damages, one must know what the plaintiff would have done absent the defendant’s fraud. When the plaintiff bought or sold a publicly traded security, she had an almost infinite number of alternatives. The plaintiff might have traded at some later time or not at all. Alternatively, the plaintiff might have traded at the same time but at a different price.

If the plaintiff would have traded at the same time anyway, but at a different price, the “pure” out of pocket or “expedient” out of pocket measures would be appropriate. If the plaintiff would not have traded and would have maintained that position until the time of judgment, the rescissory measure might be proper; but fairness might require the plaintiff to mitigate damages, in which case the cover measure would be appropriate.

The problem is determining what the plaintiff would have done absent the fraud. Any plaintiff testimony may be self-serving. The plaintiff may choose the alternative that maximizes recovery. For example, if the stock price has steadily increased since the plaintiff sold, the plaintiff may claim that she would have held until the time of judgment.

With a class action, each plaintiff is not even available to give self-serving testimony. Furthermore, the plaintiffs are not uniform and would have pursued different courses of action absent the fraud. Some would not have traded at all; others would have traded at different times. Therefore, no one measure of damages is “fair.”