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SENTENCING GUIDELINES

Expert Analysis

The 2012 Guideline Amendments: Missed Opportunities?

By **Alan Vinegrad**

The U.S. Sentencing Commission recently announced that it was considering various amendments to the Sentencing Guidelines. These proposed amendments—the result of a multi-year review of fraud offenses—called for a number of possible changes to the guidelines for these offenses. While some proposals signaled a continuation of the now-longstanding trend toward harsher punishment for certain white collar offenders, others would have actually reversed that trend and would have resulted in more lenient treatment under the fraud guideline of less culpable defendants convicted of large-dollar frauds.[1]

But last Friday, the commission announced the amendments it actually adopted—which, absent affirmative rejection by Congress, will become effective on Nov. 1, 2012. As we will see, the adopted amendments reflect a narrower, more cautious approach to sentencing guideline reform—with the changes largely in the direction of increased severity.[2]

Harsher Punishments

The increases in punishments for white-collar crimes are in direct response to a congressional directive (in the Dodd-Frank Wall Street Reform and Consumer Protection Act) that the commission ensure that the guidelines reflect the serious nature of these offenses, the need for deterrence and punishment, and the effectiveness of imprisonment in furthering these objectives. To that end, the commission proposed a series of changes to the guidelines for fraud, insider trading and financial institution-related crimes to increase punishment for these offenses.

The general fraud guideline (2B1.1) currently has 18 separate enhancements, containing 40 different ways to increase a defendant's guideline range. In a reflection of evident congressional dissatisfaction with that number, the commission considered yet another one—a two-to-six level increase if the offense involves a "significant disruption of a financial market" or a substantial risk of such a disruption. Alternatively, the commission asked whether an upward departure for this factor should be adopted. In the end, it chose the latter approach (to be codified in Application Note 19(A)(iv)).

In a similar vein, the commission proposed increasing the severity of the insider trading guideline—based, it said, on "public comment" that insider trading defendants "do not necessarily realize high gains." At the moment, the insider trading guideline (2B1.4) is quaint in its simplicity, with a base offense level of 8 and a single enhancing variable—the defendant's gain. The commission proposed to change that—suggesting a two-level enhancement for "sophisticated" insider trading (defined as "especially complex or intricate offense conduct pertaining to the execution or concealment of the offense") and a further, 4-level enhancement if the defendant had a "position of trust" (namely, an officer or director of a public company, a registered broker, dealer or investment adviser, or various commodities-related positions). These changes would have mirrored similar enhancements already in place under the general fraud guideline.

But the commission didn't stop there. It also asked whether insider trading defendants who do not reap large gains should nevertheless face more serious punishment based on the magnitude of their trading. Thus, the commission considered adding a guideline enhancement based on the number of transactions, the dollar value of the transactions and the number of stocks involved, and ultimately asked whether it should promulgate an alternative definition of gain, under which gain would be the larger of (i) the gain, or (ii) 20 percent of the volume of trading.

Ironically, recent insider trading cases provide not only the apparent impetus for these potential changes, but also grist for those who would question their necessity. Take the recent, so-called Galleon prosecutions in the Southern District of New York: Those cases resulted in jail terms of 11 years (for the lead defendant, Raj Rajaratnam), 10 years (for the lead defendant in a related, seven-defendant case) and an average of nearly three years for a dozen other Wall Street figures. The highest sentence would have been higher still, but for the defendant's serious health issues and extensive record of charitable giving. For eight recent Southern District of New York insider trading defendants convicted after trial, the average sentence was six years in prison.[3]

In the end, the commission opted for amendments that reflect, to varying degrees and with somewhat different verbiage, the same inclination toward harsher sentences in insider trading cases as the original proposals. Specifically, the amendments (i) call for a minimum base offense level of 14 in cases involving an "organized scheme" (defined to include the factors underlying the possible alternative-gain definition), and (ii) instruct that the general, two-level abuse-of-trust enhancement (3B1.3) should be applied if the defendant's job entails "regular participation or professional assistance in creating, issuing, buying, selling, or trading securities or commodities" and was used to "facilitate significantly the commission or concealment of the offense."

New Ways to Calculate Loss

On a facially more neutral note, the commission has recognized the confusion surrounding the calculation of losses in securities fraud cases. They initially set forth the four most common methods for calculating those losses—the rescissionary, modified rescissionary, market capitalization and market-adjusted methods—and asked whether these, or some other method, should become de rigueur in securities fraud cases. Eventually, the commission opted for the modified rescissionary method—meaning, loss will presumptively be the difference between (i) a stock's average price during the period of the fraud, and (ii) the average price for 90 days after the fraud is disclosed to the market. Notably, the guideline (Application Note 3(F)(ix)) provides that the court may also consider the extent to which any of the change in value resulted from factors other than the fraud.

ALAN VINEGRAD, *former U.S. Attorney for the Eastern District of New York, is a partner at Covington & Burling.*

The commission's action is welcome recognition that the loss causation standards that are familiar terrain to civil securities litigators—by virtue of the Supreme Court's decision in *Dura Pharmaceuticals v. Broudo*[4] and its progeny—have a role to play in calculating what is usually the single most important factor in a criminal fraud case. Indeed, it is hard to fathom why the standard for punishment in a criminal case should be easier to meet than the standard confronting the plaintiff in a civil securities case.

Minor Defendants

Over the last 15 years, the fraud guideline has climbed ever higher, as enhancement upon enhancement have accumulated over time. As a consequence, the average punishment in fraud cases has climbed 77 percent during that time, and defendants convicted of large-loss frauds face guideline ranges approaching—if not reaching—life in prison.

These astronomical guideline ranges have resulted in two separate but related phenomena that caused the commission to re-think this get-tougher approach. First is the fact that fraud cases with large loss amounts have "relatively high rates of below-range sentences"—as courts (and even prosecutors) find ways to ameliorate the harshness of the fraud guideline. Second, the commission has received public comments and reviewed court decisions "suggesting that the impact of the loss table or the victims table…may overstate the culpability of certain offenders" in fraud cases. The latter comment is certainly euphemistic: Federal judges in New York City, for example, have described the fraud guideline as "a black stain on common sense" that sometimes results in an "utter travesty of justice" and sentences "[un]moored to fairness."

Much like Congress and the commission employed the "safety valve" in an effort to ameliorate the harshness of the sentencing regime for drug offenses, the commission set about to consider whether to "limit the impact of the loss table or the victims table (or both)" in certain large-loss fraud cases. Its initial proposals were promising.

First, it asked whether a defendant who gains little relative to the loss amount should have his or her sentence "capped" at a significantly reduced level than would otherwise apply. Specifically, under the commission's initial proposal, if a defendant's gain did not exceed $10,000, the loss enhancement—which currently can be as high as 30 levels—would be capped at either 14 or 16 levels; for gain not greater than $25,000, the cap would be either 16 or 18 levels; and for gain not greater than $70,000, the cap would be either 18 or 20 levels. If you do the math, these gain amounts and loss-level caps were premised on a 100:1 ratio of loss to gain: for example, for a defendant who gained no more than $70,000, the loss enhancement would be capped at either 18 (corresponding to a loss of up to $7 million) or 20 (corresponding to a loss of more than $7 million).

Second, the commission suggested limiting the 4- and 6-level victim enhancements (which are based on the number of victims) to cases in which the offense "substantially endangered the solvency or financial security" of at least one victim.

Third, the commission—in a welcome recognition of the harsh impact of multiple fraud enhancements—considered whether to limit the cumulative impact of the loss and victims tables by providing, for example, that if the loss enhancement is a certain amount (say, anywhere from 14 to 24 levels), then the 4- or 6-level victim enhancement would not apply.

And to round out consideration of these issues, the commission solicited views on whether (1) these adjustments should instead take the form of downward departures, (2) any other approaches should be employed to address the impact of the loss and victims tables, (3) these adjustments should be employed in all or only some fraud cases, and (4) to extend these changes (if adopted) to other guideline provisions that use the fraud guideline as a starting point for their respective calculations.

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To give numerical color on these verbal formulations, let's take the case of a defendant in a $450 million, public company securities fraud case with more than 250 shareholder victims (none whom were endangered financially) and in which the defendant personally gained nothing. Assuming no other aggravating or mitigating adjustments, that defendant's adjusted offense level is currently 43—which translates into life (yes, life) in prison. Assuming the commission's proposal had been adopted, then this defendant's adjusted offense level would have been as low as 21, or 37-46 months in prison. A dramatic difference indeed.

Alas, the commission's final amendment is a shadow of these proposals. It did not adopt a loss "cap" for small-gain defendants; it did not adopt the requirement that at least one victim be financially endangered in order to apply the 4- or 6-level victim enhancement; and it did not adopt the prohibition of victim enhancements in large-loss cases. Instead, it suggested that a downward departure "may" be warranted in cases involving small amounts of loss suffered by large numbers of victims, on the theory that, in these cases, the loss and victim enhancements may produce an offense level that substantially overstates the seriousness of the offense.

The Future

To be sure, the commission's press release announcing these amendments[5] suggests that further changes may be in order. It describes the amendments as a "first step in a multi-year review of the fraud guideline" and notes that any changes to that guideline may impact over 30 other guidelines—leading the commission to conclude that any such changes "must be undertaken comprehensively."

Time will tell whether the recent adoption of a single mitigating change to the fraud guideline is merely a small first step toward the eventual return of rationality to the white collar guidelines—or a disappointing retreat from the earlier suggestion of more meaningful sentencing reform.

1. The proposed amendments are available at http://www.ussc.gov/Legal/Federal_Register_Notices/20120119_FR_Proposed_Amendments.pdf.
2. The amendments adopted by the commission are available at http://www.ussc.gov/Legislative_and_Public_Affairs/Newsroom/Press_Releases/20120413_UNOFFICIAL_RFP_Amendments.pdf. Amendments to the guidelines for human rights, drug and other offenses also were adopted.
3. See D. Glovin, P. Hurtado and B. Van Voris, "Galleon Insider Sentencing Scorecard: Average Prison Term Tops 3 Years," available at www.bloomberg.com (Oct. 14, 2011).
4. 544 U.S. 336 (2005).
5. Available at http://www.ussc.gov/Legislative_and_Public_Affairs/Newsroom/Press_Releases/20120413_Press_Release.pdf.