

# Measuring “Gain” under the Insider Trading Sentencing Guideline Based on Culpability for the Deception



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## I. Introduction

The principal driver of sentences in white-collar cases is typically the dollar amount of “loss” to the victims or “gain” to the defendant. In many cases, the magnitude of harm to the victim or the defendant’s profit from his wrongdoing can provide a helpful starting point for measuring the defendant’s culpability. But the Guidelines’ singular focus on raw numbers has come under more and more scrutiny as prison sentences for white-collar offenders have increased substantially in recent years.<sup>1</sup> For example, as the Second Circuit has pointed out, former WorldCom CEO Bernie Ebbers’s sentence of 25 years’ imprisonment was “longer than the sentences routinely imposed by many states for violent crimes, including murder, or other serious crimes such as serial child molestation.”<sup>2</sup> Judge Rakoff of the Southern District of New York has noted the “travesty of justice that sometimes results from the Guidelines’ fetish with abstract arithmetic, as well as the harm that Guidelines calculations can visit on human beings if not cabined by common sense.”<sup>3</sup>

Part of the “common sense” in the application of the Guidelines, as some courts increasingly are coming to understand, is that in financial crimes, the “gain” or “loss” that is calculated, and therefore the principal factor upon which punishment is based, should take into account only the amount of harm that is actually *caused* by the criminal conduct. Harm caused by other, independent market forces should be excluded from the calculation, even if quantifying the precise amount attributable to the crime increases the complexity of the sentencing process.

The issue arises most often in cases involving public companies, where the defendant is accused of “cooking the books,” and thereby artificially inflating the share price, or of insider trading. In an accounting fraud case, for example, the Government generally will seek to measure loss based on the amount by which the price of the company’s stock decreases after the fraud is revealed to the marketplace. However, many factors affect the price of stock, including “changed economic circumstances, changed investor expectations, new industry-specific or firm-specific factors, conditions, or other events, which taken separately or together account for some or all of that lower price.”<sup>4</sup> And, if punishment and relative culpability

are to be based on loss to victims or gains to the defendant, the numbers ought to *exclude* the extraneous factors and measure the defendant’s culpability based solely on the loss or gain that can be attributed to his wrongdoing.

A number of courts and scholars have addressed this issue in the context of the loss Guideline. In this article, we consider this problem in the context of the insider trading Guideline,<sup>5</sup> which provides for an increase in the base offense level based on “the gain resulting from the offense.”<sup>6</sup> The Government often argues that the amount a convicted insider trading defendant’s sentence is enhanced should be based on the total profit from the defendant’s trades, rather than the amount of that profit that is attributable to his use of deceptive information. Suppose, for example, that a defendant buys \$1,000 worth of stock in a pharmaceutical company, based on inside information about an anticipated positive earnings announcement. The day after the disclosure of the earnings data, the stock increases in value to \$1,200. One month later, the FDA approves a new cancer drug developed by the company, and the value of the shares rises to \$1,500. The defendant then sells the stock. The Government would argue that the gain under the Guideline is \$500—that is, the defendant’s entire profit from the trades. However, in this example it is clear that only (at most) \$200 of gain is causally connected to the defendant’s deception—that is, his purchase of the shares on the basis of the material nonpublic information about the earnings release. An approach that limits the amount of gain to that caused by the deception, we argue below, is more faithful to the text of the Guideline, the long-established measure of disgorgement of ill-gotten gains in civil insider trading cases, and the purposes of the Sentencing Reform Act.

## II. Judicial Interpretations

This issue has been litigated at least twice in recent years, first in the Eighth Circuit and more recently in the insider trading case of former Qwest Communications CEO Joseph P. Nacchio, whose conviction was recently reversed by the Tenth Circuit.<sup>7</sup> Both courts sided with the Government.

### A. The Eighth Circuit

The first and only appellate court to rule on the proper interpretation of the Guideline is the Eighth Circuit,

*Federal Sentencing Reporter*, Vol. 20, No. 3, pp. 194–200, ISSN 1053-9867 electronic ISSN 1533-8363  
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which addressed the issue en banc in *United States v. Mooney*.<sup>8</sup> Mooney was the vice president of underwriting for United Healthcare Corporation. Beginning in February 1995, United was in negotiations to acquire Metra-Health, which would have made United the largest health care services company in the country. During these negotiations, Mooney attended many confidential due diligence inquiries between the companies and “spent four days looking through Metra’s financial records, membership projections, cost data, and confidential Book of Business.” Despite corporate counsel’s reminder that participants in the meetings should not trade in stock during the due diligence period, upon returning from the four-day meeting, Mooney immediately sold 20,000 shares of stock that he recently had purchased and used some of the proceeds to purchase call options in United stock as well. Over the following months, he eventually sold the options, grossing \$532,482.49, as compared to his cost of \$258,283.03, for a total profit of \$274,199.46.

After Mooney had completed his purchases, the market became aware (through a *New York Times* article on June 21, 1995) that Metra and United were in “advanced discussions.” United confirmed the ongoing discussions in a press release that same day. Trading volume increased substantially and the stock price immediately rose 5%. The next day, the *Wall Street Journal* reported additional speculation about the acquisition and United shares rose an additional 6%. A few days later, United announced the agreement. The day before the *New York Times* article appeared, United shares closed at \$40.125. On July 15, they closed at \$44.50, and on October 5, they were over \$49.00.

Mooney later was indicted and convicted on charges of insider trading. At sentencing, the district court calculated the “gain resulting from the offense” for purposes of the Guidelines based on Mooney’s total profit—that is, the gross amount Mooney realized from the sale of his options minus his cost. The district court determined that that entire amount constituted “gain resulting from the offense” and set the Guideline range at 37–46 months’ imprisonment.

On appeal, Mooney argued for the adoption of a “market absorption approach”—to be borrowed from civil insider trading cases—according to which his gain would have been much less than the \$274,199 realized in the transactions. His point was that the Guideline should be interpreted against the backdrop of the long-established and court-developed remedy of disgorgement, which applies in civil insider trading cases. According to the market absorption approach, the gain is calculated as the “profits causally connected to the violation” or “the difference between the value of the shares when the insider sold them while in possession of material, nonpublic information, and their market value ‘a reasonable time after public dissemination of the inside information.’”<sup>9</sup> The analysis in civil insider trading cases thus recognizes that there is legitimate

value exchanged in a sale even where one party trades on the basis of inside information and, therefore, the illicit gain for the inside trader is limited to the amount attributed to his deception. This is uniformly the holding across the Circuits, and there appear to be no cases to the contrary.

Mooney argued that the market would have reasonably absorbed his inside information within a few days after United announced its Metra acquisition and that the value of his call options on that date could have reflected the information. Mooney argued that this market value was \$308,750, and after subtracting the purchase price of the options, he arrived at a “gain resulting from the offense” of \$50,467.47. This figure would have resulted in a Guideline range of 24–30 months.

The Government responded by focusing on the amount realized from the transactions and cited the Guideline commentary, which, it argued, “expressly disapproves of any attempt to measure the severity of the offense in terms of victim losses.” It further argued that different standards should be employed for civil and criminal cases and argued that disgorgement is “limited to victim losses, for using total gain could result in an unjust windfall for private victims.” The Government also argued that “Mooney’s proposed standard . . . is inherently speculative and would require the sentencing court to identify the point at which material nonpublic information is fully assimilated by the market. That would involve extensive factfinding, and in the present case it would be difficult to say when, if ever, the market had fully assimilated all of the nonpublic information Mooney possessed.”

**1. The Majority Opinion** The Eighth Circuit began with the plain language of the Guideline itself, which it noted refers to “the defendant’s gain, not to market gain.”<sup>10</sup> It rejected Mooney’s argument that the language should be read to incorporate a market absorption approach, holding that “any question about the Guideline’s meaning is decisively resolved by the authoritative definition provided in the commentary.” That commentary, in full, states the following:

This Guideline applies to certain violations of Rule 10b-5 that are commonly referred to as “insider trading.” Insider trading is essentially treated as a sophisticated fraud. Because the victims and their losses are difficult if not impossible to identify, the gain, *i.e.*, the total increase in value realized through trading in securities by the defendant and persons acting in concert with the defendant or to whom the defendant has provided inside information, is employed instead of the victims’ losses.

The court concluded that the commentary “succinctly points out” that gain “means ‘the total increase in value realized through trading in securities.’”

The court emphasized the apparent clarity of the language of the commentary and concluded that “[t]here is

nothing difficult about the terms ‘total increase in value’ or ‘trading in securities’ and in the context of securities transactions *realize* means to convert securities . . . into cash.” The court further concluded that the term *realized* makes it “clear” that the Guideline addresses the total profit a defendant actually made from his trades.

The court also noted that the commentary specifically rejects victim losses as a method of calculating gain “because of the difficulty of ascertaining the victims and their losses for such offenses.” The court then asserted that the methodology used in civil cases calculates victim losses, and because the commentary rejects victim losses as a method for determining gain, the Guideline thus rejects the standards applied in civil cases. It also found no support in the Guidelines or decisions of other courts for applying to criminal cases the analysis applied in a long history of civil cases. It based this conclusion primarily on its belief that civil cases are intended to make victims whole whereas criminal cases focus on punitive goals. “Criminal prosecutions for violations of securities laws are different,” the court asserted.

Finally, the court articulated policy reasons why the “gain resulting from the offense” language in the Guideline should be interpreted as the total amount realized in the transaction. It lauded the Guideline’s approach for providing a clear rule that, because it precludes any consideration of when the market has absorbed the information, limits the fact-finding required of district courts. According to the court, the “[i]mprecise standards” of a market absorption approach are not appropriate for the criminal context, whereas focusing on the total amount of profit in the trades follows the Congressional mandate that sentences reflect the seriousness of the offense.

**2. The Dissent** Judge Bright, joined by Judges Lay and Bye, vigorously dissented. He accused the majority of an interpretation where “punishment depends on the gyrations of the stock market.”<sup>11</sup> Judge Bright reasoned that courts cannot know what the “gain resulting from the offense” is without knowing what “the offense” is. Pointing to the statute of conviction, Section 10(b) of the Securities Exchange Act,<sup>12</sup> Judge Bright argued that the offense is not the purchase or sale of stock itself—which is a lawful act—but rather “the *use of a manipulative or deceptive contrivance in connection with*” the purchase or sale of stock.<sup>13</sup> Thus, the offense is the deception, and the “gain resulting from the offense” is the gain resulting from the deception. Judge Bright also argued that the gain stops when the deception stops and that a defendant should not be held responsible for additional stock market gyrations once the deception has ended.

By reference to a hypothetical, Judge Bright demonstrated how the majority’s interpretation would result in unequal sentences for equal crimes. He posited three executives (Larry, Moe, and Curly) who “each separately, at the same time, with the same insider’s knowledge, buy

1,000 shares of stock at a price of five dollars per share. Four weeks later, the insider knowledge is made public, and after the fifth week that knowledge has been absorbed by the market and the stock price reflects that knowledge. On the day the knowledge can be said to have been absorbed by the market, the stock price has risen from five dollars per share to fifteen dollars per share.”<sup>14</sup> Larry then sells his shares that same day, making a profit of \$10,000. This entire amount is illicit gain and can be traced directly to his deceit. Moe and Curly do not sell at that time; instead, Moe sells three months later when the stock has increased significantly to \$50 per share. Moe therefore has total capital gains of \$45,000: the first \$10,000 represents his gain from the exploitation of his insider knowledge, but the remaining \$35,000 is the product of ordinary market fluctuations and is not tainted by his earlier deception. Curly still does not sell until six months later, when, after the market has crashed, he sells for \$2 per share and sustains a loss.

Judge Bright pointed out that each defendant in this case has committed exactly the same crime with exactly the same effect on the market. And if the “gain resulting from the offense” is in fact the “gain from the deception,” the Guidelines will prescribe the same enhancement for each defendant. Under the majority’s interpretation, however, Larry would receive a 2-level increase for a \$10,000 gain, Moe a 6-level increase for a \$45,000 gain, and Curly no increase at all, because he lost money on the purchase.<sup>15</sup> Thus, assuming each defendant is a first-time offender, Larry would be subject to an additional 6 months of imprisonment; Moe, an additional 22 months; and Curly, no additional time.

Judge Bright also chastised the majority for its unsupported assertion that civil standards cannot be applied in criminal cases because criminal cases are “different.” He pondered how the gain from a single act of insider trading could be \$1,000 when the SEC sues the perpetrator but could be \$5,000 when the Department of Justice prosecutes the perpetrator.<sup>16</sup>

### **B. *United States v. Nacchio***

In April 2007, Joseph P. Nacchio, the former CEO of Qwest Communications, was convicted of nineteen counts of insider trading.<sup>17</sup> His conviction was subsequently reversed by a panel of the Tenth Circuit. Because the Court granted Nacchio a new trial, it did not need to address his sentencing arguments. The proceedings in the district court are still instructive on how courts have interpreted “gain.” At sentencing, the Colorado district court followed the majority view in *Mooney* and rejected the defense’s argument that Judge Bright’s dissent was correct. The court determined, therefore, that Nacchio’s gain was approximately \$28 million—the total amount received from his sales of stock (\$52 million) less his costs incurred in the transactions. The court relied heavily on the commentary, finding it “clear and unmistakable.” It rejected

Nacchio's approach, deferring to the commentary's statement that "victims and their losses are difficult if not impossible to identify," and concluded that civil standards have no place in criminal law. The court did "acknowledge that the Moe, Curly and Larry hypothetical is a little bit troublesome" but chose to ignore it, concluding that "I don't need to deal with it, do I? Because that's not this case."<sup>18</sup>

### III. "Gain" Should Include Only Ill-Gotten Gain

#### A. The Guideline Language

The majority in *Mooney* started in the correct place, acknowledging that "[i]n interpreting the Guidelines, we start with the plain language of the Guideline itself." But it then turned too quickly to the commentary for its conclusions. If the language of the Guideline is plain—and words in a Guideline are to be given their ordinary meaning—"it is not necessary to look beyond the plain language."<sup>19</sup> As Judge Bright demonstrated, to understand "gain resulting from the offense," one must know what the offense is. Neither the *Mooney* majority nor the district court in *Nacchio* addressed this point. But the courts need not have looked only to the plain language of the statute of conviction, 15 U.S.C. § 78j. They also could rely on the Supreme Court's decision in *United States v. O'Hagan*,<sup>20</sup> which indicates that "the offense" of insider trading is the deception that accompanies any purchase or sale of securities. For example, *O'Hagan* makes clear that the insider has either a "duty to disclose" or a duty to "abstain from trading." And the Court held that "[d]eception through nondisclosure is central to the theory of liability."

Nor, when the words are given their ordinary and accepted meanings, is *gain* in the context of insider trading a foreign concept. In civil cases, the remedy might be called disgorgement, but courts always have calculated the "gains of the[] wrongful conduct"<sup>21</sup> or the "profits causally connected to the violation."<sup>22</sup> And in doing so, they have treated the "wrongful conduct" or "the violation" as the deception that accompanied a purchase or sale of securities, not the purchase or sale itself. Thus, ill-gotten gain has long been treated as "the difference between the value of the shares when the insider purchased [or sold] them while in possession of material, nonpublic information, and their market value 'a reasonable time after public dissemination of the inside information.'"<sup>23</sup> Moreover, despite being advisory, the Guidelines are still treated in the same mandatory fashion as statutes, which "are to be read with a presumption favoring the retention of long-established and familiar principles," absent "a statutory purpose to the contrary."<sup>24</sup>

The Government nonetheless argued in *Mooney* and in *Nacchio* that methods for calculating "ill-gotten gains" in civil fraud cases do not apply in the criminal context, and the courts agreed. Neither the Government nor the courts have been able to point to any authority precluding the application of civil standards in criminal cases, and courts

often, in interpreting similar language, look to different contexts for guidance.<sup>25</sup> Just recently, in fact, in a case addressing the loss Guideline, the Second Circuit rejected a similar argument and instead held: "[W]e see no reason why considerations relevant to loss causation in a civil fraud case should not apply, at least as strongly, to a sentencing regime in which the amount of loss caused by a fraud is a critical determinant of the length of a defendant's sentence."<sup>26</sup>

It makes sense as a legal matter to interpret the Guideline against the backdrop of long-standing interpretations of gain in the insider trading context. But it also makes sense as a policy matter to calculate gain, and to impose commensurate punishment based on that number, in a manner that ties the gain to the actual or—as the Supreme Court has described it—the "real [criminal] conduct."<sup>27</sup> Congress's goals of greater sentencing uniformity based on real conduct and avoidance of unwarranted disparities—goals that necessarily inform the interpretation of the Guideline—can be achieved only by recognizing the importance of the causal relationship between conduct and sentence.<sup>28</sup> Stated another way, and as a matter of simple common sense, a defendant should not serve prison time for a loss he did not cause or a gain he did not obtain illegally.

Civil insider trading cases also have long recognized the flaws in the Eighth Circuit's approach—as highlighted by Judge Bright's hypothetical. In *SEC v. MacDonald*, the First Circuit rejected the Government's approach, explaining that it "would depart from the principle of 'equal footing,' and measure assessments by purely fortuitous circumstances."<sup>29</sup> And in *SEC v. Shapiro*, the Second Circuit addressed a defendant in Curly's situation—who traded on inside information but lost money when the market eventually dropped—but held that the amount of disgorgement was the gain from the deception, and he was held accountable for more than he made from his trades.<sup>30</sup>

#### B. The Commentary

Perhaps wary of the plain language of the Guideline, the Eighth Circuit majority and the district court in *Nacchio* focused heavily on the commentary. In particular, they focused on the commentary's statement that "[b]ecause the victims and their losses are difficult if not impossible to identify, the gain, *i.e.*, the total increase in value realized through trading in securities . . . is employed instead of the victims' losses." But this statement does not go as far as the courts suggest. In *Mooney*, for example, the court concluded that "[i]n the civil context the amount to be disgorged is limited to victim losses" and that because the Guideline commentary expressly disavows any reliance on victim losses, the market absorption approach cannot be used in the criminal context. But the reason the commentary gives for eschewing victim losses is that "their losses are difficult if not impossible to identify." On the court's reading, that would necessarily mean that disgorgement is

impossible to calculate.<sup>31</sup> That makes no sense, especially because courts have been making these sorts of calculations for decades. The reference to “victim losses” in the commentary is more likely a simple acknowledgment that the insider’s deception causes individual loss to particular individuals who bought their shares based on the insider’s deception but that identifying each particular individual and aggregating their individual losses is “difficult if not impossible”—and so the more realistic approach is to measure what the defendant gained from his deceptive conduct.

The Eighth Circuit majority’s interpretation, moreover, puts the commentary and the plain language of the Guideline in conflict—requiring, of course, adherence to the Guideline itself.<sup>32</sup> Courts understandably are reluctant to read the commentary in a way that renders it a nullity. But this commentary can be read consistent with an interpretation of the Guideline that calculates the gain resulting from the deception.

The Eighth Circuit and the district court in *Nacchio* concluded that the “total increase in value realized through trading in securities” can mean only that if a defendant sells 100 shares at \$10-per-share profit (\$1,000 in total), and after the disclosure of his inside information, the stock is trading at \$4 per share less (leaving \$6-per-share profit), the “total increase in value realized” is \$1,000 because the defendant converted \$1,000 of stock into \$1,000 in cash profit—that is, he realized \$1,000 in profit. But that is forced reasoning. The commentary defines gain as the “total increase in value,” not simply the “total value realized.” Thus, it recognizes that the shares already have value and a defendant should be held responsible only for any increase in value that he realizes as a result of his deception. In the example above, when the defendant sells his shares for \$1,000, at that time the shares have \$6 of legitimate profit and \$4 of additional value that the market mistakenly attributes to the shares based on the defendant’s deception. By selling the shares at \$10-per-share profit, the defendant has increased the value he realized through trading by an illegitimate amount of \$4 per share—or, stated another way, he has avoided not realizing \$4 per share in illegitimate value. The shares still have a legitimate value of \$6-per-share profit, and the defendant did not “increase” the value he “realized through trading” by any of that \$6.

The same goes for an inside buyer of shares, like Mooney, who bought in anticipation of an acquisition. If the insider buys 100 shares at \$10 per share before the market is aware of the acquisition the insider knows will occur, he is buying \$1,000 worth of legitimate value, and the person he bought the stock from is receiving \$1,000 worth of legitimate value. Unbeknownst to that seller, however, the insider is aware of an impending acquisition that, once publicly revealed, will likely increase the share price. If at the same time the acquisition-related information is released, however, a separate unrelated event occurs that the insider had no prior knowledge about—

perhaps an unanticipated interest rate cut—and the stock soars 50% to reach \$15 per share, the insider will have gains causally related to the deception, as well as additional gains that are independent of the deception and result from market responses to information he was not privy to until after his trade. The insider is therefore “increasing” the value that he was entitled to “realize[] through trading” by the amount attributable to the deception, not by the amount attributable to the increase in the stock price due to the interest rate cut. Yet under the approach of the Eighth Circuit and district court in *Nacchio*, the inside buyer has “increased” his value by \$500—the full increase in stock price. That makes little sense.

That interpretation of the commentary, of course, also leads to the problems identified in Judge Bright’s hypothetical. In its brief to the Tenth Circuit in *Nacchio*, the Government did not dispute the persuasive logic of Judge Bright’s analysis but instead resorted to the generic assertion that, under the Supreme Court’s decision in *Rita v. United States*,<sup>33</sup> a court always is “required to impose a ‘reasonable’ sentence and could depart or vary from the advisory range as justice and uniformity demanded.”<sup>34</sup> Of course, that is true, but it is no answer to the fact that its interpretation results in unequal sentences for the same real conduct, in contravention of the statutory sentencing goals *Rita* was interpreting.<sup>35</sup>

#### IV. Representing a Defendant Charged with Insider Trading

At the earliest point in the case, long before sentencing is litigated, defense counsel should consider retaining an expert to conduct a market study or “event study” to analyze the impact of the information on the price of the stock, and therefore the amount of gain that can be attributed to the material nonpublic information as opposed to other market forces. Courts have recognized that “[m]any variables have the potential to and do affect a stock price. . . . To this end, expert testimony may be helpful because of the utility of statistical event analysis for this inquiry.”<sup>36</sup> An event study will exclude those factors unrelated to the deception and will isolate the amount of gain, if any, that can be attributed to the information’s impact on the market.

The earlier the expert is retained and the analysis conducted, the better. It may be useful, among other things, in negotiations with the Government. If the expert can demonstrate that the amount attributed to the fraud is low, that fact may be helpful in persuading a practical prosecutor to offer a reasonable plea deal.

If a sentencing hearing becomes necessary, and the court agrees with Judge Bright, the expert report inevitably will be crucial to demonstrating the limited nature of the gain resulting from the deception, and the Government most certainly would retain its own expert with a different analysis. Should the court adhere to the majority position in the Eighth Circuit, however, the analysis also is useful

for demonstrating that, under the Section 3553(a) factors, the amount of gain calculated by the court overstates the seriousness of the offense, and the court should take that into account when imposing a reasonable sentence.

Finally, it is useful to know and to point out that although in *Mooney* and *Nacchio* the Government argued that *gain* includes all of the defendant's profits, in the guilty plea context it has at times acquiesced in calculations limiting gain to the amount resulting from the deception. For example, in the case of Paula Rieker, a former Enron officer, the Government negotiated a plea agreement stipulating that the gain was limited to the amount attributed to the deception, as opposed to the total amount she realized from her trades.<sup>37</sup>

## V. Conclusion

Without legislative change, the current trend toward longer and longer white-collar sentences is likely to continue unabated, especially in light of the continuing prominence of the Guidelines after *Rita*. Nevertheless, a more sensible approach to interpreting the Guidelines that are largely responsible for these sentences can provide a principled basis for tailoring white-collar sentences more closely to the offense. Just as many courts have limited the calculation of loss to the harm actually caused by the defendant's crimes, courts should determine gain under the insider trading Guideline by reference to the amount of the defendant's gain that is, in fact, ill-gotten and the product of his deception.

## Notes

- \* Ms. Shapiro is a former Assistant United States Attorney in the Southern District of New York, where she also served as Deputy Chief Appellate Attorney.
- See, e.g., Peter J. Henning, *White Collar Crime Sentences after Booker: Was the Sentencing of Bernie Ebbers Too Harsh?*, 37 McGEORGE L. REV. 757 (2006) (determination of loss is often the most important factor in applying the Guidelines, but the Guidelines provide little guidance of the calculation); Stephanos Bibas, *White-Collar Plea Bargaining and Sentencing after Booker*, 47 WM. & MARY L. REV. 721, 739-40 (2005) (noting flexibility prosecutors have to manipulate loss amounts to affect sentencing).
  - United States v. Ebbers*, 458 F.3d 110, 129 (2d Cir. 2006). Other very lengthy white-collar sentences include 15 years for John Rigas, the 80-year-old founder of Adelphia, 20 years for Timothy Rigas, 30 years for Patrick Bennet, and 20 years for Steven Hoffenberg. And just recently, first-time offender Chalana McFarland saw her 30-year sentence for mortgage fraud affirmed, in an unpublished opinion, by the Eleventh Circuit. *United States v. McFarland*, No. 05-14374, 2007 U.S. App. LEXIS 27413 (11th Cir. Nov. 23, 2007). See also Ellen S. Podgor, *Throwing Away the Key*, 116 YALE L.J. POCKET PART 279 (2007) (noting the long sentences now routinely given to first-time white-collar offenders, including the Guidelines sentence of over 24 years' imprisonment for Jeffrey Skilling).
  - United States v. Adelson*, 441 F. Supp. 2d 506, 512 (S.D.N.Y. 2006).
  - Dura Pharmaceutical, Inc. v. Broudo*, 544 U.S. 336, 343 (2005).
  - U.S.S.G. § 2B1.4.

- The Guideline provides for a base offense level of 8, and the text of the "specific offense characteristic" at issue here states in full: "If the gain resulting from the offense exceeded \$5,000, increase by the number of levels from the [loss] table in § 2B1.1." U.S.S.G. § 2B1.4(b)(1). This calculation is the chief determinant of the Guideline sentencing range. For example, for a first-time offender whose "gain resulting from the offense" is less than \$5,000, resulting in no increase from the base offense level, the Guideline range is 0-6 months' imprisonment. For a first-time offender whose gain is more than \$200,000, the Guidelines specify a 12-level increase and a range of 33-41 months. If the gain is more than \$1,000,000, the range increases to 51-63 months; for a gain of more than \$50,000,000, the range is 121-151 months, or 10-12.5 years' imprisonment.
- The authors and their colleagues at Latham & Watkins represent Mr. Nacchio in his appeal. His conviction was reversed on March 17, 2008. At the time of publication, however, the Government had not yet decided whether to seek rehearing.
- 425 F.3d 1093 (8th Cir. 2005).
- SEC v. Happ*, 392 F.3d 12, 31 (1st Cir. 2004). See also *SEC v. Maxxon, Inc.*, 465 F.3d 1174, 1179 (10th Cir. 2006); *SEC v. Patel*, 61 F.3d 137, 139-40 (2d Cir. 1995) ("gains of the[] wrongful conduct" is the difference between the price paid or received for the shares and "the price of the shares shortly after the disclosure of the inside information").
- 425 F.3d at 1099.
- Id.* at 1105 (Bright, J., dissenting).
- 15 U.S.C. § 78j(b); see also SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.
- 425 F.3d at 1106 (citing 15 U.S.C. § 78j(b) ("It shall be unlawful for any person, directly or indirectly . . . (b) [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. . . .")) (emphasis in original).
- Id.* at 1107.
- These increases were determined using the 1994 version of the Guidelines manual.
- Id.* (citing *Mayle v. Felix*, 545 U.S. 644 (2005) (interpreting language in a criminal context with reference to interpretations of the same language in a civil context)).
- Brief for Appellant, Joseph P. Nacchio, *United States v. Nacchio*, No. 07-1311, at 3 (filed Oct. 9, 2007). In addition to challenging his sentence, Nacchio argued on appeal, see *id.*, 2008 WL 697382 (10th Cir. Mar. 17, 2008), that the evidence was insufficient as a matter of law for the jury to find him guilty, and alternatively for a new trial due to errors in the jury instructions, the improper exclusion of an expert witness, and erroneous rulings under the Classified Information Procedures Act. The court agreed that an expert witness was improperly excluded and granted a new trial.
- Sent. Tr. at 21.
- Robertson*, 350 F.3d at 1116.
- 521 U.S. 642 (1997).
- Patel*, 61 F.3d at 139-40.
- Happ*, 392 F.3d at 31.
- Id.*
- United States v. Texas*, 507 U.S. 529, 534 (1993) (citation omitted).
- See, e.g., *Mayle*, 545 U.S. 644.
- United States v. Rutkoske*, 506 F.3d 170, 179 (2d Cir. 2007).
- United States v. Booker*, 543 U.S. 220, 253 (2005).
- See, e.g., *United States v. Olis*, 429 F.3d 540, 545-46 (5th Cir. 2005) (acknowledging that the failure to take into account extrinsic factors affecting the calculation could greatly overstate the seriousness of the offense and the defendant's

culpability); *United States v. Snyder*, 291 F.3d 1291, 1296 (11th Cir. 2002) (requiring resentencing and instructing district court to recalculate loss by estimating the loss caused by the defendant's fraud); *United States v. Evans*, 155 F.3d 245, 253 (3d Cir. 1998) ("[T]he actual loss determination must be predicated on the harm caused by [defendant's] offenses.");

<sup>29</sup> 699 F.2d 47, 54 (1st Cir. 1983) (en banc).

<sup>30</sup> 494 F.2d 1301, 1309 (2d Cir. 1974).

<sup>31</sup> This, of course, is putting aside the point that disgorgement calculates "gains of the[] wrongful conduct" and "profits causally connected to the violation," not victim losses.

<sup>32</sup> *Stinson v. United States*, 508 U.S. 36, 38 (1993) (commentary "is authoritative unless it . . . is inconsistent with, or a plainly erroneous reading of, th[e] Guideline").

<sup>33</sup> 127 S. Ct. 2456, 2465 (2007).

<sup>34</sup> Brief for Appellee, United States of America, *United States v. Nacchio*, No. 07-1311, at 66 (filed Nov. 9, 2007).

<sup>35</sup> E.g., 18 U.S.C. § 3553(a)(6) ("the need to avoid unwarranted disparities").

<sup>36</sup> *Unger v. Amedisys*, 401 F.3d 316, 325 (5th Cir. 2005). The event study is not only useful for sentencing purposes, of

course. The information's impact on the market also is directly relevant to whether the information is material. See Alan R. Bromberg & Lewis D. Lowenfels, *Bromberg & Lowenfels on Securities & Commodities Fraud*, § 6:153 ("Opinion evidence, e.g., by experts . . . is admissible on whether information would have a substantial market impact."); *id.* § 6:159 ("Experts . . . should be able to testify that the information would have had a substantial effect on the market price or that reasonable investors would have considered it important."); *id.* § 6:151 (same); 5 *Business & Commercial Litigation in Federal Courts* § 62:77, at 1042 (Robert L. Haig ed., 2005) (In securities cases, "economic experts often play the most significant role of any witness" especially when it comes to "whether the disclosure of certain information had an effect on the market price and, if so, what amount" and whether it "was 'material.'"); 7-107 E. Michael Bradley & Anthony L. Paccione, *Securities Law Techniques* § 107.03 (Matthew Bender ed., 2007) ("In securities litigation, expert testimony has been found helpful and been admitted with respect to a wide variety of matters," including "to demonstrate materiality.").

<sup>37</sup> See Plea Agreement, *United States v. Rieker*, No. CR-H-04-192 (S.D. Tex. May 19, 2004).