NEW YORK COUNCIL OF DEFENSE LAWYERS

COMMENTS OF THE NEW YORK COUNCIL OF DEFENSE LAWYERS REGARDING 2012 PROPOSED AMENDMENTS TO THE SENTENCING GUIDELINES, POLICY STATEMENTS, AND OFFICIAL COMMENTARY

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COMMENTS OF THE NEW YORK COUNCIL OF DEFENSE LAWYERS REGARDING 2012 PROPOSED AMENDMENTS TO THE SENTENCING GUIDELINES, POLICY STATEMENTS, AND OFFICIAL COMMENTARY

The New York Council of Defense Lawyers (the "NYCDL") would like to thank the Sentencing Commission (the "Commission") for the opportunity to present our views on the 2012 Proposed Amendments to the Sentencing Guidelines (the "Guidelines"), policy statements, and official commentary. We are a professional association comprised of more than 200 experienced attorneys whose principal area of practice is the defense of criminal cases in federal court. Among our members are a former United States Attorney and former Assistant United States Attorneys, including previous Chiefs of the Criminal Divisions in the Southern and Eastern Districts of New York. Our membership also includes current and former attorneys from the Federal Defender offices in those districts.

Our members thus have gained familiarity with the Guidelines both as prosecutors and as defense lawyers. In the pages that follow, we address a number of proposed amendments of interest to our organization.

The contributors to these comments, including members of the NYCDL's Sentencing Guidelines Committee, are Marjorie J. Peerce, Chair, Catherine M. Foti, Laura Grossfield Birger, Brian Maas, Michael Bachner, Sharon L. McCarthy, and Christopher Conniff. We also want to acknowledge the contributions of Lisa H. Bebchick, Patrick Bumatay, Nathaniel I. Kolodny, Lauren Gerber Lee, Nicole M. Lunn, Bharathi Pillai, and Justin M. Ross.

I. COMMENTS REGARDING PROPOSED AMENDMENT: DODD-FRANK/FRAUD

The Commission has proposed a multi-part amendment that continues the Commission's multi-year review of fraud offenses to ensure that the Guidelines provide appropriate penalties

(1) in cases involving securities fraud and similar offenses and (2) in cases involving mortgage fraud and financial institution fraud. Specifically, the proposed amendment implements two directives to the Commission in the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203. The first directive relates to securities fraud and similar offenses, and the second directive relates to mortgage fraud and financial institution fraud. Each directive requires the Commission to "review and, if appropriate, amend" the Guidelines and policy statements applicable to the offenses covered by the directive and consider whether the Guidelines appropriately account for the potential and actual harm to the public and the financial markets from those offenses. Each directive also requires the Commission to ensure that the Guidelines reflect (i) the serious nature of the offenses, (ii) the need for deterrence, punishment, and prevention, and (iii) the effectiveness of incarceration in furthering those objectives.

The NYCDL believes that the existing Guidelines and policy statements applicable to offenses covered by the two directives result in most cases in a recommended advisory guidelines range that is far greater than necessary to accomplish the purposes of punishment for most defendants, and that the existing guidelines and policy statements should be reviewed and amended to ameliorate some of their harsh effects, particularly in cases involving securities, mortgage, and financial institution fraud. As will be discussed further herein, we believe that if adopted, many of the proposed amendments will result in automatic increases in the advisory guidelines range for these offenses, which are already unduly harsh, and likely further increase the number of downward departures and variances from the Guidelines. Indeed, increased variances from the guidelines range or sentences at the very low end of the guidelines range send a clear message that the existing guidelines for these offenses already yield unduly severe punishment. To increase the advisory guidelines ranges for these offenses by adding further and

additional enhancements would simply result in more departures and variances in an effort by judges to reach more sensible and just results that properly balance the seriousness of the offense with the individual culpability of the defendant.

Moreover, in terms of general deterrence, most studies have noted that it is the certainty of prosecution, *i.e.* getting caught, that creates the real deterrent, not whether the defendant receives a sentence of one year versus five years.[1] Combined with the statistics that federal prisons throughout the country are overcrowded and the U.S. is incarcerating individuals at rates far surpassing other countries,[2] we urge that there be a more balanced reaction to the financial crisis and the enactment of Dodd-Frank and a recognition that simply increasing the length of incarceration is not the solution to the crisis.

As will be addressed herein, the NYCDL's position is that far from needing to further increase the terms of incarceration called for by the Guidelines, the Guidelines are harsh enough as written. The Commission should consider amendments to the Guidelines and policy statements in the future that work to more appropriately reflect the culpability of individual defendants and to reduce the number of exorbitantly high advisory guidelines ranges that arise in a substantial number of cases.

(A) Harm to Financial Markets and Public: Issue for Comment 1

The Commission has requested comment on whether the Guidelines Manual provides

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1 *See* Sally S. Simpson, CORPORATE CRIME, LAW, AND SOCIAL CONTROL 35 (Cambridge Press 2002) (reviewing decades of literature on deterrence and white collar crime and concluding that "the importance of formal legal sanctions for deterring criminal conduct appears to depend on one's commitment to criminal activities, the influence of other inhibitory mechanisms in one's life, … the perceived benefits of illegal conduct relative to its costs, and alternative opportunity structures. . . . When sanction threats are taken into account by potential offenders, *certainty of punishment tends to matter more than sanction severity. The body of evidence, then, tends to only weakly support a deterrence perspective.*") (emphasis added).

2 *See* Paul Guerino, Paige M. Harrison, & William J. Saboaige, BUREAU OF JUSTICE STATISTICS BULLETIN: PRISONERS IN 2010, at 7 (Dec. 2011) ("The Federal Bureau of Prisons operated at 36% above reported capacity at yearend 2010."); Roy Walmsley, INTERNATIONAL CENTRE FOR PRISON STUDIES, WORLD PRISON POPULATION LIST, at 1 (8th ed. 2008) (stating that "[t]he United States has the highest prison population rate in the world, 756 per 100,000 of the national population").

penalties that appropriately account for the potential and actual harm to the public and the financial markets from the offenses covered by the directives. Section 2B1.1 already contains provisions that address harm to the public and financial markets in various ways, by taking into account the amount of loss, the number of victims, and other factors contained in the specific offense characteristics and departure provisions. The NYCDL believes that the current Guidelines more than adequately account – and, in many cases, yield overly-harsh results – for potential and actual harm to the public and financial markets in securities fraud and similar offenses, mortgage fraud and financial institution fraud. In this regard, we further believe that there is no need for a new prong in § 2B1.1 to provide for an enhancement of up to six levels if the offense involved a significant disruption of a financial market or created a substantial risk of such a disruption. Where a fraudulent scheme results in significant disruption of a financial market or creates a substantial risk of such disruption, the Guidelines already provide for significant penalties in the loss table and with other existing enhancements, such that defendants in those cases often find themselves at the outer bounds of the Sentencing Table, and beyond the statutory maximum sentences allowed by law.[3] For the same reasons, we do not believe the Commission should add a new upward departure provision to § 2B1.1 that would apply if the offense involved such a disruption or created a substantial risk of such disruption.

(B) Securities Fraud and Similar Offenses

1. Insider Trading: Proposed Amendment to § 2B1.4

The Insider Trading Guideline (§ 2B1.4) is one of the guidelines that the Commission proposes to amend in order to address Dodd-Frank's directive to "review and, if appropriate,

[3] *See, e.g.*, Transcript of Sentencing, *United States v. Madoff*, 09 CR 213 (DC) (S.D.N.Y. June 29, 2009) (defendant's conduct resulted in billions of dollars in losses and yielded a total offense level of 52, resulting in a Guidelines-recommended sentence of life imprisonment).

amend" the securities fraud-related guidelines to insure appropriate accountability for the actual and potential harm to the public and financial markets from securities and mortgage fraud crimes.[4] In particular, the Commission is considering whether § 2B1.4 should include offense level enhancements for (1) "sophisticated" acts of insider trading; and (2) offenses involving individuals holding certain identified positions of trust. The NYCDL urges the Commission not to implement either of these proposed enhancements because, as set forth more fully below, both of these concepts are addressed in the current version of the Guidelines and would only result in unnecessarily higher offense levels and concomitant increased departures and variances from the Guidelines.

As the Commission itself has recognized, the addition of unnecessary offense characteristics is creating a "factor creep" in sentencing, and "more and more adjustments . . . to the sentencing rules" are making it "increasingly difficult to ensure that the interactions among them, and their cumulative effect, properly track offense seriousness."[5] Adding the proposed enhancements to an insider trading guideline that already accounts for these factors would exacerbate this problem. While the rationale for Dodd-Frank's directive may be well-meaning, focusing on increasing the Guidelines offense levels for mortgage and securities frauds in reaction to public uproar is not the solution.

a. *The Insider Trading Guideline Was Created to Address What the Commission Identified as a Sophisticated Fraud*

The Commission proposes a two-level increase in the base offense level, reaching at least a minimum enhancement of an offense level twelve or fourteen, for all offenses involving what it

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4 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010).

5 U.S. SENT'G COMM'N, FIFTEEN YEARS OF GUIDELINES SENTENCING, 137 (Nov. 2004), *available at* http://www.ussc.gov/Research/Research_Projects/Miscellaneous/15_Year_Study/15_year_study_full.pdf [hereinafter "FIFTEEN YEARS"].

characterizes as "sophisticated insider trading." The Commission's amendment appears, in part, to be a response to cries from the law enforcement community for higher sentences in the white-collar area. For instance, the United States Attorney for the Southern District of New York, Preet Bharara, addressed this issue publicly, urging the Commission in a 2011 speech to apply the "sophisticated means" enhancement under § 2B1.1 to "sophisticated insider trading" under § 2B1.4.[6]

The problem with the Commission's proposal, however, is that the sophisticated nature of insider trading is covered by the current guidelines. The Commentary under the current guideline specifically states that insider trading is "treated essentially as a sophisticated fraud."[7] In defining the enhancement in the proposed Commentary and Application Notes, the Commission states that courts should be looking for "especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense" – virtually the same concept that exists already. This proposed enhancement would result in essentially double-counting for a concept addressed already, and simply raise recommended prison sentences and the frequency of departures and variances from the Guidelines.

Even assuming *arguendo* that a "sophisticated means" enhancement were appropriate here, the Commission's proposed factors for consideration do not actually distinguish "sophisticated" frauds from other "simpler" cases, and would likely result in disparate sentences for the same criminal conduct. The Commission suggests that the following factors should be used to determine whether an enhancement for sophisticated insider trading applies: the number of transactions; the dollar value of the transactions; the number of securities involved; or some

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[6] Proposed Amendments to the Federal Sentencing Guidelines: Hearings before United States Sentencing Commission (Feb. 16, 2011) (Statement of Preet Bharara), *available at* http://www.ussc.gov/Legislative_and_Public_Affairs/Public_Hearings_and_Meetings/20110216/Testimony_DOJ_%20Bharara.pdf.

[7] U.S. SENTENCING GUIDELINES MANUAL, cmt., § 2B1.4 (2011).

other factor that distinguishes a defendant who engages in multiple instances or higher volumes of insider trading from a defendant who does not. While each one of these factors, such as a large number of transactions, may occasionally signal sophisticated insider trading, less "sophisticated" insider traders could equally have large numbers of transactions and dollar amounts that evidence a degree of activity rather than any special "sophistication." Accordingly, these proposed factors will frequently lead to unreliable, inconsistent results. This is particularly true with the electronic trading platforms that make high volume (and high monetary value) trading widely available to the public at large. The sentencing court can address the occasional case where there is a greater level of sophistication by taking that into account in determining the appropriate sentence. To create an automatic increase for what will likely be the vast majority of insider trading cases is, we urge, unnecessary and unwarranted.

Two recent cases demonstrate the weakness of the Commission's proposed approach. In *United States v. Walker*,[8] the court found that the defendant did not engage in sophisticated fraud as the conduct was "not notably more intricate than the typical or garden variety," even though the fraud involved a large number of transactions. Contrast that with *United States v. Fiorito*,[9] where a district court found "sophisticated means" were used even though the defendant conducted a small number of transactions.

The Commission should leave the insider trading guideline as is, recognizing that the sophisticated nature of the crime is contemplated in the base offense level. Courts can decide where to sentence utilizing § 3553(a), and if the conduct is particularly sophisticated, take that into account in the ultimate sentence.[10]

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[8] 2011 WL 3417110, at *13 (E.D. Pa. July 28, 2011).

[9] 2010 WL 1507645, at *37 (D. Minn. Apr. 14, 2010).

[10] In fact, gain, the only specific offense characteristic currently in the insider trading guideline, is already under attack by the judiciary for yielding excessively harsh advisory guidelines ranges for fraud defendants. In

The Government's modified suggestion – an "organized scheme" enhancement – is equally unnecessary and duplicative. As we stated at the hearing on March 14, 2012, it would be the "exception that swallowed the rule." Similar to the "more than minimal planning" enhancement, one would soon find virtually all insider trading defendants subjected to the enhancement.

b. *Enhancements for Individuals Holding a Position of Trust*

Similarly, the proposed amendment for an enhancement for specific types of defendants is unnecessary because the current Guidelines already contain an enhancement for abusing a position of trust or special skill. Application Note 1 of the current version of § 2B1.4 references application of § 3B1.3, which permits a 2-level increase for abusing a position of trust or incorporation of a special skill. According to the Application Note, "Section 3B1.3 . . . should be applied only if the defendant occupied and abused a position of special trust. Examples might include a corporate president or an attorney who misused information regarding a planned but unannounced takeover attempt. It typically would not apply to an ordinary 'tippee.'"[11] Based on recent criminal prosecutions of insider trading and the resulting sentences, it is clear that judges are aware of and utilize the Chapter 3 enhancements for the defendant's role in the offense, including making enhancements for defendants who abuse a position of trust.[12]

United States v. Adelson, an accounting fraud case, the court found the Guidelines offense level of 42 – driven primarily by the gain/loss table and yielding an advisory guideline range of life imprisonment – was far too high. 441 F. Supp. 2d 506 (S.D.N.Y. 2006). Before sentencing Adelson to 42 months' imprisonment, it noted that "[e]ven the Government blinked at [the] barbarity" of the application of the loss table. *Id.* at 511. As set forth below, other district court judges are also routinely moving away from inordinately and unnecessarily high sentences driven by high loss or gain numbers in other fraud cases for the same reasons.

[11] U.S. SENTENCING GUIDELINES MANUAL, App. Note 1, § 2B1.4 (2011).

[12] *See* Morrison & Foerster, 2011 INSIDER TRADING ANNUAL REVIEW 10-11 (2012), *available at* http://www.mofo.com/files/Uploads/Images/2011-Insider-Trading-Review.pdf [hereinafter "2011 INSIDER TRADING"] (citing *United States v. Poteroba*, (S.D.N.Y. 2010) (sentencing Igor Poteroba to 22 months imprisonment after a finding of +8 base level, +12 gain, +2 abuse of trust enhancement added, and -3 acceptance of responsibility); *United States v. Goffer*, et al. (S.D.N.Y. 2010) (sentencing Arthur Cutillo to 30 months imprisonment after a finding of +8 base level, +12 gain, +2 abuse of trust enhancement added, and -3 acceptance of responsibility); *United States v. Santarlas* (S.D.N.Y. 2009) (sentencing Brien Santarlas to 6 months imprisonment

The Commission should leave the Guideline as is, and allow sentencing judges to rely on § 3B1.3, to increase offense levels, where appropriate, to address individuals who have abused a position of trust.

c. *The Proposed Enhancements Will Lead to Increased Variances from the Guidelines*

If adopted, the proposed amendments to the Guidelines on insider trading will result in automatic increases in the advisory guidelines range for these offenses and likely further the increasing number of downward departures and variances from the Guidelines. According to the Commission, in fiscal 2009, forty-two percent of all sentences nationwide were below the Guidelines.[13] It also appears that almost seventy-five percent of recent insider trading cases resulted in prison sentences below or at the very bottom of the range called for under the Guidelines.[14] These sentences continue to send a clear, consistent message that the judiciary believes that the Guidelines for insider trading offenses are already too harsh due to the emphasis on "gain," and do not necessarily provide an appropriate basis for rendering fair sentences in insider trading cases.[15]

Specifically, the judiciary has criticized the advisory Guidelines on high-loss economic crimes as a "black stain on common sense"[16] and "so run amok that they are patently absurd on their face."[17] In a number of recent insider trading cases, sentencing judges have varied significantly from the sentences suggested by the Guidelines. For instance, Winifred Jiau, a purported "expert" and tipper of material non-public information who went to trial, was

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after a finding of +8 base level, +12 gain, + 2 abuse of trust enhancement added, and -3 acceptance of responsibility)).

[13] *See* Andrew Longstreth, *Why U.S. inside traders escape harsh sentences*, REUTERS, Jan. 6, 2011, *available at* http://www.reuters.com/article/2011/01/06/us-insider-trading-idUSTRE7055JP20110106 [hereinafter "*Inside Traders*"].

[14] 2011 INSIDER TRADING, *supra* note 12, at 11.

[15] *Id.*

[16] *United States v. Parris*, 573 F. Supp. 2d 744, 754 (E.D.N.Y. 2008).

[17] *Adelson*, 441 F. Supp. 2d at 515.

sentenced to forty-eight months in prison – a significant sentence in the days before the Guidelines and even today. The Guidelines recommended between 97 and 121 months' imprisonment. This unreasonably high offense level was the result of enhancements of eighteen for gain, plus two for abuse of a position of trust, and two for obstruction of justice.[18] Judge Jed S. Rakoff stated, "There's no way I'm going to impose a guidelines sentence in this case. The guidelines give the mirage of something that can be obtained with arithmetic certainty."[19]

In another case, where the Guidelines range was 87 to 108 months, defendant James Fleishman, a former Primary Global Research salesman, received a significant sentence of 30 months' imprisonment for his role in passing information along as part of an "expert network." Fleishman's Guidelines calculation was based almost entirely on the calculated gain from the offense and his role. Finally, in the case that prosecutors dubbed the biggest hedge fund insider trading case in U.S. history, Judge Richard J. Holwell sentenced Galleon Group founder Raj Rajaratnam to eleven years in prison, a substantial term of incarceration, despite a Guidelines calculation that put his recommended sentence at up to twenty-five years in prison.[20] Even with a fifteen percent reduction in the sentence for good behavior, Rajaratnam's sentence still emerged as the longest sentence on record for insider trading.

Rather than creating overlapping Guidelines that require judges to consider growing numbers of duplicative enhancements, the Commission should aim to reduce the number of enhancements where the Guidelines ranges in these cases are already high enough and account for the seriousness of the offense. This would help decrease the frequency of departures and variances from the Guidelines by judges attempting to mitigate the harsh recommendations of

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[18] *See* 2011 INSIDER TRADING, *supra* note 12, at 23.

[19] Peter Lattman, *2 Defendants Sentenced in Insider Trading Case*, N.Y. TIMES DEALBOOK, Sept. 21, 2011, *available at* http://dealbook.nytimes.com/2011/09/21/2-defendants-sentenced-in-insider-trading-case/.

[20] *See Raj Rajaratnam's Insider Trading, Away with you*, THE ECONOMIST, Oct. 13, 2011, *available at* http://www.economist.com/blogs/schumpeter/2011/10/raj-rajaratnam%E2%80%99s-insider-trading.

the Guidelines. The result would be more consistency in sentencing. As we note *infra* at pages 14-15, we propose certain adjustments to allow courts to take into consideration factors they already do to achieve variances, but within the Guidelines structure itself.[21]

2. Insider Trading: Issue for Comment 1

The Commission seeks comment on whether it should provide one or more specific offense characteristics to increase enhancements under § 2B1.4 for insider trading cases. The Commission also asks whether it should consider a tiered enhancement based on the "volume of trading" for insider trading cases analogous to the "volume of commerce" enhancement under subsection (b)(2) of § 2R1.1.

a. *Further Specific Offense Enhancements*

The NYCDL strongly opposes amending § 2B1.4 to include any further specific offense enhancements, such as the following proposed by the Commission: (A) the number of transactions; (B) the dollar value of the transactions; (C) the number of securities involved; (D) the duration of the offense; (E) whether fictitious entities, corporate shells, or offshore financial accounts were used to hide transactions; and (F) whether internal monitoring or auditing systems or compliance and ethics program standards or procedures were subverted in an effort to prevent detection of the offense. We also oppose adoption of a tiered enhancement based on the volume of trading.

As discussed above, Guidelines ranges for insider trading offenses are already too high. Federal judges have sent a clear and consistent message that the Guidelines for insider trading offenses are unreasonably harsh and do not provide an appropriate basis for rendering fair

[21] It was suggested by Professor Samuel W. Buell in his written testimony as well as at the hearing on March 14, 2012, that the Commission should consider creating floors for insider trading offenses by increasing the base offense level so that most insider trading defendants receive a sentence of imprisonment. We believe this would be excessively harsh and further compound the problem of downward variances in sentencing. Judges have made clear that the problem is not that the Guidelines are too low – it is that they are too high. If the Commission is seriously considering this approach, we respectfully request an opportunity for further comment.

sentences in insider trading cases. In 2011, federal courts sentenced a record number of insider trading defendants. Nevertheless, according to a study by Morrison & Foerster, a vast majority of those defendants received sentences below or at the very bottom of the range called for by the Guidelines.[22]

Out of thirty-eight insider trading sentences imposed in 2011, only one defendant received a sentence above the lowest bounds of the advisory Guidelines range.[23] Twenty defendants received below Guidelines sentences and no defendant received a sentence above the Guidelines range.[24] The same pattern held for insider trading cases in 2010 and 2009. Combining both years, more than eighty-eight percent of sentences were below the terms prescribed by the Guidelines.[25] District Court judges in the Southern District of New York, who oversee most of the insider trading cases in this country, have varied from the Guidelines thirty percent more for insider trading cases compared to all other SDNY cases.[26]

The increasingly stiffening advisory Guidelines ranges for white collar crimes lie at the heart of the disparity between the Guidelines and federal sentences. Such high ranges are often not justified in the case of insider trading crimes, which often do not have an identifiable "victim," unlike other white-collar crimes. For example, unlike other securities frauds, such as Ponzi schemes and shareholder fraud, which no doubt harm the investing public, insider trading cases do not produce victim-impact statements to sway judges.[27] As Judge Alvin Hellerstein of the Southern District noted at an insider trading sentencing, "there are no victims in this crime, at

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22 *See* 2011 INSIDER TRADING, *supra* note 12, at 10-11.

23 *Id.* at 11, 21 (citing *United States v. Johnson*, Case No. 1:11cr254 (E.D. Va. Aug. 12, 2011)).

24 *Id.* at 11.

25 Morrison & Foerster, INSIDER TRADING: 2010 YEAR-END REVIEW 21-23 (2011), *available at* http://www.mofo.com/files/Uploads/Images/110223-Insider-Trading-2010-Review.pdf; Morrison & Foerster, INSIDER TRADING: 2009 REVIEW 16-17 (2010), *available at* http://www.mofo.com/files/Publication/b7c9f5bd-bc1a-4e8e-9254-9187c9788123/Presentation/PublicationAttachment/cdc74a8f-e2c5-48c8-a637-bfa37480fa85/100218InsiderTrading.pdf.

26 *See Inside Traders*, *supra* note 13.

27 *Id.*

least not in any real sense."[28] Currently, the Guidelines ranges in the insider trading context do not allow for more individualized assessments of the defendant or the crime. For example, a first-time offender guilty of insider trading automatically receives an extraordinarily high eight points. Even if the defendant receives no personal gain, the Guidelines call for exacting sentences. In the case of James Gansman, the Guidelines called for a base offense level of 8 and a 12-level gain enhancement for a range of 33-41 months even though Gansman personally received not one cent. Judge Miriam Goldman Cedarbaum of the Southern District sentenced Gansman to one year and one day.[29]

The Department of Justice has complained about the variance between Guidelines and court-imposed sentences. It claims that courts have created two distinct sentencing "regimes."[30] One regime includes sentences by federal judges that remain closely tied to the Guidelines. As Judge John Gleeson of the Eastern District of New York commented in a fraud case, the Department apparently believes this is the "good regime."[31] A second regime, dealing with financial fraud cases such as insider trading with large departures from the Guidelines, has, according to the Department, "lost its moorings to the sentencing guidelines."[32] In the Department's view, this "regime" is "unacceptable."[33] Judge Gleeson has highlighted the Department's complaint of so-called "regimes" to emphasize his belief that no additional amendments to the Guidelines are necessary because judges have the freedom necessary to achieve appropriate sentences by applying the factors contained in 18 U.S.C. § 3553(a).[34]

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28 *Id.*

29 *See id.*

30 Letter from Jonathan J . Wroblewski to the Hon. William K. Session III, at 1 (June 28, 2010) [hereinafter "Wroblewski Letter"].

31 *United States v. Ovid*, 09-CR-216 (JG), 2010 WL 3940724, at *1 (E.D.N.Y. Oct. 1, 2010) (statement of reasons for sentence).

32 Wroblewski Letter, *supra* note 30, at 2.

33 *Id* at 5.

34 *Ovid*, 2010 WL 3940724 at *3.

The NYCDL does not agree with the Department's view that this so-called second regime is unacceptable or that it has lost its moorings to the Guidelines. We agree with Judge Gleeson's observation that courts have the leeway to appropriately sentence defendants using the § 3553(a) factors. We also believe that this second regime of sentencing has identified a real problem with the Guidelines that needs to be corrected. These courts have made it abundantly clear that the Commission needs to ratchet down the Guideline ranges for fraud offenses and allow for greater individualization at sentencing.

The NYCDL encourages the Commission to consider, at the appropriate time, the proposal set forth below, which aims to take greater account of each defendant's individual culpability level. While this recommendation will require further study and discussion, we believe it is worthy of exploration and is relevant to the request for comment regarding § 2B1.1 with respect to other approaches that would address the impact of the loss and victims tables.

The NYCDL recommends that the Commission include certain downward adjustments to § 2B1.4(b) as nonexclusive factors that judges could consider in imposing lower sentences without departing from the Guidelines. The purpose of these downward adjustments is to distinguish between short-lived "ordinary" insider trading schemes involving few transactions and little to no gain and those that are wide-ranging and result in significant personal gain. Relatively minor offenses, involving few acts of insider trading or few co-conspirators, should not be treated the same as offenses involving long-term, multi-faceted conspiracies. For example, the ordinary "tipper" who provides inside information on one occasion should be sentenced differently from a "tipper" who engaged in a pattern of divulging inside information.

To facilitate this recommendation, the Commission could include the following factors as nonexclusive grounds for downward adjustments to § 2B1.4(b), making it clear to the courts that

these are simply guidance and nonexclusive suggestions for courts to consider when determining whether a downward adjustment would be appropriate:[35]

- The defendant was not an organizer, leader, manager, or supervisor of others in the offense or scheme.
- The offense involved no more than one act of trading of securities in furtherance of the offense or scheme.
- The offense involved no more than two acts of trading of securities in furtherance of the offense or scheme.
- The offense or scheme involved no more than two co-conspirators, including the defendant.
- The offense or scheme involved no more than three co-conspirators, including the defendant.
- The defendant voluntarily withdrew from the scheme or offense.
- The defendant did not engage in acts to conceal the scheme or offense, or the profits of the scheme or offense, from the Government.
- The defendant, not later than the time of the sentencing hearing, truthfully provides to the Government all information and evidence the defendant has concerning the offense or offenses that were part of the same course of conduct or of a common scheme or plan, regardless if the information was relevant or useful to the Government or if the Government was already aware of the information.
- The defendant was not an officer or director at the time of the offense.
- The defendant did not breach a duty of loyalty or trust to the insider.[36]

b. *Volume of Trading*

The NYCDL opposes a tiered enhancement based on a "volume of trading" scale as unworkable and counterproductive. The Commission's proposed approach is similar to the §

[35] These factors would facilitate greater flexibility and more opportunity for the Government and defendants to engage in constructive plea bargaining.

[36] With respect to the Government's proposed "mitigating role" factors at page 16 of its written testimony, all six of which, we understand, would have to be met in order for the adjustment to apply, we believe the provision would be unattainable for virtually all defendants.

2R1.1(b)(2) "volume of commerce" model applicable in the bid-rigging context. It focuses on the impact of certain activity on commerce and places an inappropriate emphasis on the insider trading defendant's position, measured by volume of overall trading in a security, rather than the actual results of the purported criminal activity. While in some rare instances insider trading may have an impact on the volume of shares in the traded security, it is unlike bid-rigging in that it does not have a clear, measurable impact on the larger market.[37] Notably, the Commission does not offer any clear guidance as to how courts would measure this "impact on commerce," particularly given the complexities of trading. For instance, will a covered short position be treated the same as a long buy? How would the impact of options trading in the underlying security be measured? District Judges will be hard pressed to figure this out.[38]

Additionally, the NYCDL believes that a volume of trading enhancement would only serve to enhance insider trading sentences which, as noted above, runs contrary to what the evidence suggests is necessary to bring the Guidelines into alignment with a significant judicial sentiment and a belief among members of the bar that these sentences already are too harsh.

3. Calculation of Loss Under § 2B1.1: Issue for Comment 2

The Commission has asked for comment on various methods of loss calculation under Guidelines § 2B1.1, which relates to, among other crimes, fraud and deceit. Section 2B1.1 is the Guidelines section used by the courts to determine the appropriate sentences in cases involving securities fraud and similar offenses. The Commission has identified four specific methods of loss calculation that have been used by the courts and seeks comment on each method: (i)

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[37] *See generally* Joerg Hartmann, *Insider Trading: An Economic and Legal Problem*, 1 GONZ. J. INT'L L. (1997-98), *available at* http://www.gonzagajil.org/ (offering arguments on the impacts of insider trading).

[38] Furthermore, § 2R1.1(b)(2) itself has created ambiguity and confusion in the antitrust field, as courts have struggled to develop a consistent method for calculation of the volume of commerce. *See, e.g.,* Melissa Maxman & Elizabeth Holdefer, Amer. Bar Assoc., Volume of Commerce and Criminal Sentences for Antitrust Violations—Alternative Interpretations in the Air Cargo Fuel Surcharge Cases (Aug. 2011) http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/aug11_maxman_7_26f.authcheckdam.pdf. Incorporating such a model under § 2B1.4 would only add needless confusion to insider trading cases.

simple rescissory method; (ii) modified rescissory method; (iii) market capitalization method; and (iv) market-adjusted method. A brief overview of the various methods of loss calculation identified by the Commission follows. Ultimately, the NYCDL recommends adopting the market-adjusted method, as discussed further below.

Simple Rescissory Method. *United States v. Grabske*[39] involved the issuance of false financial statements for a publicly traded company that overstated revenue for one quarter. The company announced the fraud at the same time as it announced a fourth quarter loss. The stock initially dropped in price, then rebounded to a price close to the pre-announcement price. The court heard from two experts whose loss calculations were wildly disparate ($1.9 million vs. $164,000), and found both loss calculations to be unreasonable for various reasons.

The court chose to apply the rescissory measure of damages,[40] which "contemplates a return of the injured party to the position he occupied before he was induced by wrongful conduct to enter into the transaction."[41] The court took a number of steps to arrive at a loss calculation of $230,000, and then stated that the rescissory method was appropriate for three reasons. First, because the court's loss estimate "may be based on the approximate number of victims and an estimate of the average loss to each victim, or on more general factors," it was appropriate to compute loss based on the average purchase price during the fraud and the average price during a relevant period after the fraud. Second, the court found that the method "eliminates, or at least reduces, the complexity, uncertainty, and expense inherent in attempting to determine out-of-pocket losses on a case-by-case basis," and posited that its use may eliminate

[39] 260 F.Supp.2d 866, 872-73 (N.D. Cal. 2002).

[40] The court took the following steps to arrive at a loss calculation of $230,000. The court: (1) determined the average price of the stock during the fraud; (2) determined the period of time in which to compute the average price after the announcement of the fraud until the next major announcement that was not fraud-related; (3) determined the average price during the above period; (4) calculated the difference in price between the two periods; and (5) multiplied the resulting number by the number of harmed shares.

[41] *Id.* at 872 (citing *In re Mego Fin. Corp. Sec. Litig.*, 213 F.3d 454 (9th Cir. 2000)).

the expense of dueling experts, which are impractical in many cases where defendants' resources are limited. Third, the court determined that uniformity in sentencing, one of the Guidelines' goals, is best achieved if experts are taken out of the picture.[42]

Modified Rescissory Method. The modified rescissory method was used by the court in *United States v. Bakhit*.[43] In *Bakhit*, as in *Grabske*, the stock did not become worthless after the fraud was disclosed. While the defendant argued that the loss was $155,000, the government agreed with the Probation Department's use of the market capitalization theory and argued that the fraud resulted in a loss of $6.9 million based upon the theory that if the fraud had been disclosed prior to the IPO, the IPO would not have occurred; thus, the loss was the full IPO proceeds. The court rejected both calculations and determined that loss should be the amount by which the stock was overvalued due to the fraud, not the entire value (*e.g.*, the full IPO proceeds), resulting in a loss of $2.8 million.

The *Bakhit* court took the following steps to determine loss. The court: (1) determined the average selling price of the shares during the life of the fraud; (2) determined the average selling price after the fraud was disclosed; and (3) multiplied the difference between the average selling price during the fraud and the average selling price after the fraud by the number of harmed shares.[44] The court found this method to be objective and consistent with the dictates of the Guidelines.[45]

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[42] The court noted that the rescissory method is mandated in civil securities fraud cases under the Private Securities Litigation Reform Act, in order to provide certainty in calculating damages and in order to avoid substantially over-stating actual damages, and found that the rescissory method was explicitly supported by the 2002 Guidelines. *Id.* at 873-74.

[43] 218 F. Supp. 2d 1232 (C.D. Cal. 2002).

[44] *Id.* at 1241-42 (following *United States v. Snyder*, 291 F.3d 1291 (11th Cir. 2002)).

[45] *Id.* at 1242. As in *Grabske*, the court preferred this method to those put forward by the parties' respective experts: "the Court can, without the aid of expert testimony or an extensive factual debate, calculate the loss based upon readily available [trading] information." *See also United States v. Brown*, 595 F.3d 498 (3d Cir. 2010) (citing *Bakhit*, 218 F. Supp. 2d at 1240-42, in support of its explanation of the "rescissory" or "modified rescissory" approach).

Market Capitalization Method. In *United States v. Peppel*,[46] the court determined loss by comparing the price of the security multiplied by the number of outstanding shares immediately before disclosure with the security price just after disclosure of the fraud. The court adopted the market capitalization method, which analyzed price differentials over a one-day trading window related to the announcement of the SEC investigation, because it "adequately excludes from the loss calculation the tangle of market forces that [the defendant] contends affected [the company's] stock price."[47] The *Peppel* court adopted the market capitalization method for the very reason the *Bakhit* court rejected it.[48]

Market-Adjusted Method. In *United States v. Olis*,[49] once again, the fraud did not render the company's stock worthless. As a result, the court noted that "numerous extrinsic market influences as well as the soundness of other business decisions by the company" can affect a company's stock price.[50] The court remanded to the district court for re-sentencing to take into account extrinsic market influences that impacted the company's price decline.[51]

In *United States v. Rutkoske*,[52] the district court relied on the government's expert to calculate loss, using a date that was three months after the charged conspiracy and thus improperly attributing the total amount of the stock's decline to the defendant's conduct.[53] The court stated that "'[t]he loss must be the result of the fraud,'" and "losses from causes other than

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[46] 2011 WL 3608139 (S.D. Ohio Aug. 16, 2011).

[47] *Id.* at *7; *see also United States v. Olis*, 429 F.3d 540, 546-47 (5th Cir. 2005) (describing market capitalization approach as "basing loss on a gross correlation between stock price decline and the revelation of a fraudulent transaction").

[48] The market capitalization method was explicitly rejected by the *Bakhit* court because, "by using only the trading price just prior to the fraud, there is an increased risk that outside factors affecting share price will be given undue weight. Publicly traded stock is inherently volatile and a calculation that focuses on a single day of trading may be more representative of outside events than either the overvaluation due to the fraud or the true value of the company after disclosure of the fraud." *Bakhit*, 218 F. Supp. 2d at 1239.

[49] 429 F.3d 540, 546 (5th Cir. 2005).

[50] *Id.* at 547.

[51] *Id*. at 548-49.

[52] 506 F.3d 170, 179 (2d Cir. 2007).

[53] *Id.*

the fraud must be excluded from the loss calculation."[54] The court remanded the case to the district court for re-sentencing in order to consider other factors relevant to the stock's decline. The NYCDL believes the Commission should adopt the market-adjusted method, consistent with the *Rutkoske* and *Olis* decisions, as discussed further below.

4. Amendments to § 2B1.1 to Clarify Method Used in Determining Loss

The Commission has asked whether § 2B1.1 should be amended to clarify the method or methods used in determining loss in cases involving securities fraud and similar offenses to ensure that the guideline appropriately accounts for the potential and actual harm to the public and the financial markets from those offenses. Specifically, the Commission has asked whether it should direct a specific method or methods for use by courts in determining loss in cases involving securities fraud and similar offenses, and, if so, which method or methods should the Commission provide, and should the method used depend on the type of fraudulent scheme.

Guidelines § 2B1.1 has been amended numerous times in an effort by the Commission to provide guidance to the courts on loss calculation by, for example, providing a specific method or methods for calculating loss. The NYCDL applauds the Commission's efforts to achieve uniformity in sentencing in securities fraud and related cases, but it is our position that such efforts will likely have unfair results in most cases. Section 2B1.1, note 3(C) now states that "The court need only make a reasonable estimate of the loss. The sentencing judge is in a unique position to assess the evidence and estimate the loss based upon that evidence. For this reason, the court's loss determination is entitled to appropriate deference." As it is now written, § 2B1.1 allows the sentencing court to take into account a number of factors, some of which may or may not be present in every case. The cases discussed above illustrate better than any factual scenario

54 *Id.*

we can conjure that different fact patterns call for different responses from the court in determining loss. It is evident from the cases discussed above, however, that courts have a tendency to reject the "battle of the expert" and to settle on a tempered view of loss when the facts allow. The Commission should take care to guard the courts' ability to exercise discretion in order to fully account for the nuances of each particular case.

In particular, the Commission seeks comments on what method or methods of loss calculations should be used for two particular types of securities fraud:

> (1) Investment fraud, in which victims are fraudulently induced to invest in companies or products related to securities (a category that includes Ponzi schemes); and
>
> (2) Market or price manipulation fraud, in which the offender seeks to inflate the price of a security through various means (a category that includes so-called "pump and dump" schemes as well as accounting frauds).

a. *Investment Fraud*

The Commission asks if it should revise or repeal Application Note 3(F)(iv) to § 2B1.1 and provide a different rule for investment fraud. The Application Note reads:

> Ponzi and Other Fraudulent Investment Schemes.—In a case involving a fraudulent investment scheme, such as a Ponzi scheme, loss shall not be reduced by the money or the value of the property transferred to any individual investor in the scheme in excess of that investor's principal investment (*i.e.*, the gain to an individual investor in the scheme shall not be used to offset the loss to another individual investor in the scheme).

The NYCDL does not think that Application Note 3(F)(iv) should be repealed, but it should be revised. The rule properly captures the typical nature of a Ponzi scheme: one victim's gain comes at the loss of another victim. The rule does not, however, provide clear guidance as to how to calculate loss in cases of investment fraud, including Ponzi schemes. Accordingly, we encourage the Commission to adopt a revised rule, which states that in all cases of investment fraud, including Ponzi schemes, loss must be measured by the net out-of-pocket loss of the

victims. This approach is consistent with the fundamental loss calculation tenet that loss is the greater of actual or intended loss, as set forth in Application Note 3(A).

Courts recognize that there is room for guidance from the Commission on the issue of how to calculate loss for an investment fraud defendant. Although the Second Circuit recently upheld the district court's calculation of loss for the Ponzi scheme at issue in *United States v. Hsu*,[55] it expressly limited its holding to say that this method of loss calculation was but one way to reasonably estimate loss, and by no means the only or even the most equitable manner to do so.[56]

Hsu's application of the Ponzi scheme rule is illustrative of the downside of emphasizing loss above all other sentencing factors. Loss is a crude instrument to be used when the court can and should be considering the nature, breadth and duration of the Ponzi scheme at issue. Instead, by hinging so much of the offense conduct on the "intended loss," courts must strain common sense and logic in making their loss calculations. There is no disagreement as to how to calculate the "actual loss" in a Ponzi scheme – take the amount of money victims invested in the scheme and reduce it by any money returned to the victims. But to calculate "intended loss," particularly under *Hsu*, is far less straight-forward. Applying the *Hsu* rule requires an inquiry into the amount of money the victims *believed* they had earned through the Ponzi scheme.[57] In *Hsu*, the defendant challenged this calculation by arguing that interest and promised gains were being added to his loss calculations, a contention the court rejected because "[w]hen an investor in a Ponzi scheme faces the choice either to withdraw or to reinvest, the choice to reinvest – an

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[55] 2012 WL 516199 (2d Cir. Feb. 17, 2012).

[56] *See id.* at *8 (including in the loss calculation the fictitious returns defendant had promised to his investors irrespective of the "fact that such money may never have 'existed'"); *id.* at *9 ("other methodologies might have been appropriate in this case, and might even be preferable in other cases depending on the particular facts of the case.").

[57] *Id.* at *8.

act frequently necessary to maintain the scheme itself – transforms promised interest into realized gain that can be used in the computation of loss for the purposes of federal sentencing."[58]

The problems with the *Hsu* approach are many. First, it is often a highly speculative endeavor for the sentencing judge to determine what the victims *thought* they lost, as opposed to what they actually lost.[59] Second, as the Eighth Circuit noted, it is a legal fiction to call any of the loss in a Ponzi scheme "intended loss" – a Ponzi scheme defendant does not intend to cause a loss for the defendant's victims; so long as the fraud can be maintained, the defendant believes that everyone can benefit and the intended loss is arguably zero.[60]

The NYCDL is neither arguing that the intended loss for Ponzi schemes will always be zero nor that there will never be a Ponzi scheme in which the intended loss exceeds the actual loss. Rather, we are arguing that while culpability determinations that turn on *actual* loss are flawed, culpability determinations that depend on *intended* loss are even less reliable. Moreover, reliance on loss under either approach would not properly account for the culpability of the Ponzi scheme defendant. Our position on loss in the context of Ponzi schemes is thus consistent with our general position: the Guidelines should deemphasize loss and instead focus more on the conduct of the defendant in determining the sentence. Excessive weight and emphasis on loss can distort the search for an appropriate sentence.

Finally, the NYCDL would note that moving away from fictitious loss calculations will eliminate the need to justify the radical disparity in how we treat a victim's loss in the context of

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58 *Id.*

59 *See id.* ("[In] some instances, the task of defining 'reinvestment' will be a difficult factual inquiry that district courts will have to pursue with care. While the basic architecture of a Ponzi scheme is consistent from one scheme to the next … the details in each case will vary. What constitutes interest precluded from consideration during sentencing in one context may be the very loss intended in another.").

60 *See United States v. Hartstein*, 500 F.3d 790, 800 (8th Cir. 2007) ("In the present case, Hartstein's concessions as to numerous victims suffice to demonstrate that, at least as to several victims, she borrowed money she knew she could not repay but for the false and misplaced hope that she could perpetuate her fraud indefinitely.").

a criminal sentencing as opposed to in the context of a disgorgement action against a bankruptcy estate. At present, many courts have taken a different position on loss calculation for Ponzi schemes with peculiar results. The Second Circuit faced this issue with the victims of Bernard Madoff, who wanted repayments to be based upon the "last statement value," meaning the amount of money they believed they could redeem from Madoff at the peak of the Ponzi scheme.[61] The court in *Madoff* rejected the victims' argument, holding that it was their net investment that would determine the relative value of each claim.[62]

b. *Market Manipulation Fraud*

The Commission has asked what method or methods of loss calculations should be used in market manipulation fraud cases. The NYCDL urges the Commission to adopt the *Dura/Olis/Rutkoske* market-adjusted method for loss calculation for cases of market manipulation fraud, much as the NYCDL advocates for this standard for cases of securities fraud in general. However, we do not endorse the creation of a specific set of rules to be applied to market manipulation cases as opposed to other forms of securities fraud; for purposes of sentencing, there is nothing to be gained from distinguishing market manipulation from other forms of securities fraud, and it will only lead to confusion in having multiple ways of calculating loss in only a certain class of cases.

The NYCDL would note that *Rutkoske*, which articulates the market-adjusted loss calculation method we endorse for all securities fraud cases, is actually a market manipulation

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[61] *See In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229 (2d Cir. 2011).

[62] *See id.* at 241 ("The Trustee properly declined to calculate 'net equity' by reference to impossible transactions. Indeed, if the Trustee had done otherwise, the whim of the defrauder would have controlled the process that is supposed to unwind the fraud."); *see also Hsu*, 2012 WL 516199, at *7 n.3 (reconciling *Madoff* and *Hsu* because in the civil context, "[a]ttempts to compensate victims … may involve controversial efforts to disgorge gains from some investors in order to compensate losses of others. . . . In the criminal sentencing context, where the purpose is punishment, we look at the *greater* of either actual losses suffered to the victims or the losses the defendant intended to accomplish by virtue of the scheme. The analysis is thus appropriately distinct from that implicated in calculating an award of victim restitution.") (internal citations omitted).

case. In *Rutkoske*, the sentencing judge originally adopted the government position that any decline in the value of the stock subject to the pump-and-dump scheme should factor into the defendant's loss calculation. The Second Circuit reversed, holding that "[m]any factors may cause a decline in share price between the time of the fraud and the revelation of the fraud. In such cases, losses from causes other than the fraud must be excluded from the loss calculation."[63]

This rule applies equally to any instance of securities fraud. If the government can correlate the investors' loss to a defendant's conduct, it is reasonable to include those losses in the loss calculation.[64] But if the correlation between the loss to investors and the actions of the market manipulating defendant lack the clear causal link, then the defendant is being punished for market factors outside of his or her control.[65]

c. *Causation Standard for Calculating Loss*

The Commission has asked whether it should provide further guidance regarding the causation standard to be applied in calculating loss in cases involving securities fraud or similar offenses. The NYCDL believes that the Commission should provide further guidance regarding the causation standard, and submits that the Commission should adhere to the *Rutkoske* and *Olis* decisions, in which the courts found that the Supreme Court's decision in *Dura Pharmaceuticals, Inc. v. Broudo*,[66] "provides useful guidance" and that "considerations relevant to loss causation in a civil fraud case should . . . apply, at least as strongly," in criminal securities fraud cases, where "the amount of loss caused by a fraud is a critical determinant of the length of a

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63 *United States v. Rutkoske*, 506 F.3d 170, 179 (2d Cir. 2007).

64 *See, e.g.*, *United States v. Ware*, 577 F.3d 442, 454 (2d Cir. 2009) ("The 12-step enhancement of Ware's offense level pursuant to Guidelines § 2B1.1(b)(1)(G) for the amount of loss caused by his offenses was justified … by evidence that investors in SVSY and IT Inc. lost some $397,000 during the relevant period ….").

65 *Cf. United States v. Reifler*, 446 F.3d 65, 109-10 (2d Cir. 2006) (affirming two judges' loss calculations because the district judges found that defendants' participation in the stock fraud was the proximate cause of the stock price dropping when the government issued a press release announcing that it was investigating defendants; it was reasonably foreseeable that the stock price would drop once the fraud was discovered and the defendants' conduct was the proximate cause of the victims' losses).

66 544 U.S. 336 (2005).

defendant's sentence."[67] *Dura* "should be the backdrop for criminal responsibility both because it furnishes the standard of compensable injury for securities fraud victims and because it is attuned to stock market complexities."[68]

The Commission has asked whether there are any other changes that the Commission should make regarding the determination of loss in cases involving securities fraud or similar offenses to ensure that the guidelines appropriately account for the potential and actual harm to the public and financial markets from those offenses. In a word, "no." The NYCDL believes that simplicity and consistency are important here. From the perspective of calculating loss, the rules should not overly muddy the water with new categories of special offense characteristics and the like. The goal should be to make the Guidelines a template for consistency and reasonableness among the judiciary when faced with different defendants around the country.

5. Specific Provisions in § 2B1.1: Issue for Comment 3

The Commission seeks comment on whether any changes should be made to either or both of the enhancements at § 2B1.1(15) and (b)(18) in response to the directive, including whether the Commission should expand the scope or the amounts of the increases provided by subsection (b)(15) or (b)(18), or both, to ensure that the Guidelines appropriately account for the potential and actual harm to the public and the financial markets. The NYCDL does not believe the Commission should expand the scope or amounts of the increases provided by subsections (b)(15) or (b)(18), as the Guidelines already provide substantial punishment in the § 2B1.1 loss table. If anything, we believe reductions are appropriate.

If a serious fraud were to substantially endanger a financial institution or the financial

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[67] *Rutkoske*, 506 F.3d at 179.

[68] *Olis*, 429 F.3d at 546; s*ee also United States v. Nacchio*, 573 F.3d 1062 (10th Cir. 2009) (directing the district court on remand to eliminate the gain caused by legitimate price appreciation, as well as the underlying inherent value of the stock; approving the use of a disgorgement formula generally used in civil insider trading cases).

markets, the resulting increase in the offense level as a result of the loss table, plus the additional enhancements in § 2B1.1 that already exist, would ensure a sentence at the outermost limits of the Guidelines. Similarly, the categories of individuals to receive the four-level increase under (b)(18) are already sufficiently broad to capture most defendants and sufficiently punitive at an increase of four levels.

(C) Mortgage Fraud and Financial Institution Fraud

The Commission proposes four amendments relating to mortgage fraud and seeks comment as to whether the Guidelines appropriately account for the "potential and actual harm to the public and the financial markets from these offenses." The proposed amendments are two additions to Application Note 3 and two additions to Application Note 12.

1. Proposed Additions to Application Note 3

The Commission proposes two additions to Application Note 3 relating to the calculation of loss for cases of mortgage fraud. The first proposed addition is to create a new Specific Offense Characteristic for mortgage fraud, and to include in the loss calculation any "reasonably foreseeable administrative costs to the lending institution associated with foreclosing on the mortgaged property" provided that the lending institution exercised "due diligence in the initiation, processing, and monitoring of the loan and the disposal of the collateral."[69] The second addition would provide guidance on how to credit a foreclosed mortgage against a loss.[70]

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[69] The proposal adds the following new category to the end of Note 3(A)(v):

"(IV) Fraud Involving a Mortgage Loan. In the case of a fraud involving a mortgage loan, the reasonably foreseeable pecuniary harm includes the reasonably foreseeable administrative costs to the lending institution associated with foreclosing on the mortgaged property, provided that the lending institution exercised due diligence in the initiation, processing, and monitoring of the loan and the disposal of the collateral."

[70] The proposal adds the following sentence to the section on credits against loss at the end of Note 3(E)(ii):

"In the case of a fraud involving a mortgage loan in which the collateral has been disposed of at a foreclosure sale, use the amount recovered from the foreclosure sale."

The Commission invites comment on whether there are other issues involving loss in mortgage fraud cases that are not adequately accounted for in the Guidelines and, if so, what changes should be made to how loss is calculated in mortgage fraud cases.

The NYCDL respectfully submits that the Guidelines do not require any changes to properly deter and punish mortgage fraud. The proposed changes to Note 3 would only further complicate the ability to calculate the applicable guidelines range for fraud, requiring factual inquiries by sentencing judges that would be burdensome and, in many cases, impossible to accomplish. As we have argued elsewhere in this submission, our view is that the Guidelines should reduce the emphasis on loss in determining a sentence, whether it be the actual or intended loss.

a. *Proposed Addition to Application Note 3(A)(v)(IV)*

The first proposed addition adds to the loss calculation any "reasonably foreseeable administrative costs to the lending institution" associated with foreclosure, provided that the lending institution exercised its own due diligence. Both of these inquiries would likely be complicated searches for facts which may not be ascertainable, but if ascertainable, would likely only be found within the far reaches of large institutions. Moreover, the addition of the concept of "reasonably foreseeable administrative costs" is too vague and ambiguous to give any guidance to defendants or the courts. Whether it is intended to include attorneys' fees, court costs, internal write-downs or other costs is entirely unclear. This subjective category of costs will only lead to greater inconsistency in sentencing. Additionally, because there are so many different foreclosure schemes depending upon the jurisdiction in which the property was located, the impact of this proposed addition to the loss calculation could vary widely from case to case.

The due diligence element of the first proposed addition adds even more complexity:

whose due diligence would the court be assessing? The proposed amendment references the due diligence of the foreclosing institution, but sentencing judges would first need to determine which lender presently owns the mortgage, how many lenders have owned it, and what degree of due diligence was conducted when the mortgage was held by each successive lender.[71] Many mortgage lenders have gone out of business. Many mortgages were securitized and originating lenders, if still in business, may not have kept records. The burden on sentencing courts trying to apply this factor would be excessive.

The NYCDL urges that the appropriate loss calculation for mortgage fraud is to look at how much money remains outstanding on the loan and subtract from that the amount of money received by the original lender when it first sold the loan. Additionally, the value of the collateral must be credited against the loss. This calculation is employed by sentencing judges and is the fairest way to capture the loss attributed to a mortgage fraud.[72] Moreover, the Guidelines already provide a two-step approach to calculating loss in mortgage fraud cases, as described in *United States v. Mallory*:[73]

> The first step is to calculate the reasonably foreseeable pecuniary harm resulting from the fraud. This amount will almost invariably include the full amount of unpaid principal on the fraudulently obtained loan, as an unqualified borrower's default is clearly a reasonably foreseeable "potential result of the offense" within the meaning of Application Note 3(A)(iv). After all, the entire purpose of loan qualification criteria is to reduce the risk to banks that debtors will default on their loans…. Accordingly, the loss of the unpaid principal is an eminently foreseeable consequence of the fraudulent conduct. Partial recovery of this loss through seizure and sale of collateral may reduce the net loss amount through operation of the "credits against loss" provision, but it does not diminish the foreseeability of the financial institutions' loss of the unpaid principal amounts in the first instance.
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> The second step in calculating the loss amount requires application of the "credits

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[71] *See* Heavens, Alan J., *Mortgages Likely to Change Hands*, CHICAGO TRIBUNE, Feb. 24, 2012, *available at* http://articles.chicagotribune.com/2012-02-24/classified/sc-cons-0223-mortgage-ownership-20120224_1_servicer-adjustable-rates-mortgages.

[72] *See United States v. James*, 592 F.3d 1109, 1113-16 (10th Cir. 2010).

[73] 709 F. Supp. 2d 455 (E.D. Va. 2010).

> against loss" provision. In applying this provision, courts must deduct from the calculated loss the amount actually recovered or actually recoverable by the creditor from sale of the collateral. This calculation is made as of the time of sentencing and without regard for whether this amount was reasonably foreseeable by the defendant. Where the financial institutions have sold the collateral, courts should credit the amount actually recovered in the sale. Where the collateral is held by the institution at the time of sentencing, then the fair market value of the collateral at the time of sentencing is properly credited instead. By operation of Application Note 3(E)(ii), it is irrelevant whether the diminished value of the credit against loss was reasonably foreseeable to defendant, as the loss of the entire amount of unpaid principal was a reasonably foreseeable potential consequence of defendant's conduct. Accordingly, defendant is only entitled to a credit against loss in the amount actually recovered by the banks from sale of the subject properties.[74]

The Second Circuit endorsed the *Mallory* test, finding that it ensures that "defendants who fraudulently induce financial institutions to assume the risk of lending to an unqualified borrower are responsible for the natural consequences of their fraudulent conduct. . . . Put another way, a defendant may not reasonably count on the expected sale value of collateral to save himself from the foreseeable consequences of his fraudulent conduct."[75]

Furthermore, by basing the loss calculation in part on the conduct of the lending institution, the determining factor for loss shifts from the defendant's personal responsibility for the mortgage fraud to the question of the level of due diligence of the lending institutions. In other words, it becomes the conduct of the lending institutions, not the defendant, that determines whether or not the "reasonably foreseeable administrative costs" of the mortgage fraud are added to the defendant's loss calculation. To make this determination would require the sentencing judge to conduct a trial within the trial as to the question of the conduct of each victim of the fraud to determine how stringent each victim's efforts were to prevent the fraud. Also, it is not clear if the due diligence to be considered is in the handling of the issuance of the

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[74] *Id. at* 458-59.

[75] *United States v. Turk*, 626 F.3d 743, 750 (2d Cir. 2010) (citing *Mallory,* 709 F. Supp. 2d at 458-59); *see also United States v. McKanry*, 628 F.3d 1010, 1019 (8th Cir. 2011) (holding that the test is whether the change in the housing market and the resulting loss to the lending institution were reasonably foreseeable to the defendant).

mortgage or in the servicing of the mortgage. How much does the lending institution's lack of due diligence act as an offset for the foreseeability of the loss being accrued to the defendant? Furthermore, relying upon the due diligence of the lending institutions to determine the loss is a step towards severing the requisite "causal link" between the defendant's conduct and the loss calculation.[76]

b. *Proposed Addition to Application Note 3(E)(ii)*

The NYCDL does not support the Commission's suggestions to "provide an additional special rule for determining fair market value if the mortgaged property has not been disposed of by the time of sentencing" or, for example, to "provide that, if the mortgaged property has not been disposed of by that time, the most recent tax assessment value of the mortgaged property shall constitute prima facie evidence of the fair market value."

The mandate from Dodd-Frank is only to review, and, if appropriate, amend the Guidelines to ensure appropriate terms of imprisonment for offenders involved in mortgage and bank fraud. The NYCDL respectfully submits that a review of sentencing decisions around the country reflects that there is no such need to ramp up the Guidelines with respect to mortgage and bank fraud crimes.[77] We believe it would be impossible for the Commission to devise a fair Guideline that encompasses the wide array of approaches used to determine the assessed value of real property, because in many cases the assessed value bears no rational relationship to the fair market value of the property. The rules vary from state to state, and even in some states between

[76] *See United States v. Whiting*, 471 F.3d 792, 802 (7th Cir. 2006) (reversing a sentence because the actual loss was calculated based on the total of all unpaid medical bills that had no causal link to defendant's misrepresentations about the health benefits).

[77] *Mallory*, 709 F. Supp. 2d 455 (finding loss in excess of $2.5 million based on difference between unpaid principal on 11 mortgages and amount received through foreclosure sales; *see also United States v. McKanry*, 628 F.3d 1010, 1019 (calculating loss at $732,753.47, "the difference between the unpaid principal balance of the twelve mortgages and the subsequent sales price of the properties," and rejecting defendant's calculation of $78,628.56).

cities and counties.[78] Thus, using assessed value as a substitute for the value of the collateral if a sale has not taken place is neither a fair proxy for fair market value nor would it be consistent across the country. It is already established that the government may propose a value for the loss calculation, and the defendant may rebut that calculation.[79] It would only complicate matters to tie a judge's hands when the knowledge of how best to approximate fair market value and the estimated loss is something best determined by the judge at the time and place of the sentencing and not by some variable assessment method used by different tax authorities in villages, cities and states across the country.

2. Commentary, Application Notes, 12(A) (Subsection (b)(15)(B)(i))

The current version of Application Note 12(A) for Section 2B1.1 provides a "non-exhaustive" list of factors that the court shall consider in determining whether the safety and soundness of a financial institution was substantially jeopardized as a result of the offense. Currently, the non-exhaustive list includes four factors, including whether the institution became insolvent, was forced to substantially reduce benefits, was unable to refund any deposits or payments, or was forced to merge because its assets were substantially depleted. The Commission proposes to include a fifth factor, namely whether any of the first four factors "was

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[78] New York, for example, allows each municipality to determine the different factors and indicia that will be used in determining the assessed value. *See* Department of Taxation and Finance, *available at* http://www.tax.ny.gov/research/property/equal/rar/index.htm. So, for instance, in New York City assessed value can be calculated in one of three ways for any given property: 1) comparable sale prices for similar properties; 2) income producing potential of the property; or 3) land value and cost of constructing, reproducing or replacing your building, which is then subject to a mathematical formula. *See* NYC Finance, *available at* http://www.nyc.gov/html/dof/html/property/property_val_estimate.shtml. Moreover, there are statutory limits to how much the property assessments can increase from year-to-year. For example, assessed values of residential homes in New York City cannot increase by more than six percent each year or by more than twenty percent within a five-year period. For these reasons, fair market values historically have risen by much higher percentages than assessed values. California, by contrast, has a statewide system in which assessed value is set at the time of the last sale of property, meaning it often has no bearing on the fair market value at the time of sentencing. *See* California Const. Art. XIII A, § 2. Arizona, like New York, allows each county to determine what kind of real estate valuation to apply, but in Arizona there are several exemptions to tax assessments based on the homeowner's status such as indigence and age. *See* Arizona Property Tax, *available at* http://www.azdor.gov/PropertyTax.aspx.

[79] *See, e.g.*, *United States v. Siciliano*, 601 F. Supp. 2d 623, 633 (E.D. Pa. 2009).

likely to result from the offense but did not result from the offense because of federal government intervention." The NYCDL does not support this proposed amendment because it is ambiguous, will result in highly variable and unreliable sentencing findings, and will require substantial investigatory and judicial resources each time it is considered.

First, the scope of the proposed amendment is ambiguous. One interpretation is that the Commission intends the 4-level enhancement under 2B1.1(b)(15)(B)(i) to apply any time the impact of an offense was prevented, halted, or curtailed by the intervention of law enforcement (*e.g.*, the arrest of the defendant). An alternative reading is that the Commission intends the amendment to address only the situation where a financial institution would have suffered significant financial harm absent financial assistance provided by the government (namely, a "bailout").

Second, under either interpretation, application of the proposed amendment would be highly speculative. The proposed amendment anticipates that the court will identify and assess counterfactual circumstances, in order to determine whether the enhancement should apply. In other words, the proposed amendment invites courts to speculate about what might have happened, without any grounding in actual factual occurrences. Such speculation could result in wide disparity across similarly-situated defendants, depending on a given court's speculation about whether particular financial harms could have, but did not, occur. Moreover, it is far too vague and ambiguous a question to ask what factors that substantially jeopardized the soundness of a financial institution were mitigated only due to the intervention of the government. To place the responsibility on the defendant to defend against events that never transpired due to government intervention provides a perverse disincentive: it discourages responsible behavior for people in positions of trust who might be seeking government rescue.

Third, resolving sentencing disputes about the application of this enhancement would essentially create a trial within a trial. Ascertaining the possible financial effects of an event that did not occur would require a complex, technical inquiry into the financial health of the institution and the likely effects of certain events on its financial soundness. In almost all cases, this inquiry would necessitate expert testimony and would consume significant judicial, government and defense resources.

Finally, the four factors already identified in the existing application note are sufficient to account for the seriousness of the financial harm caused by the offense. Particularly when the current application note makes clear that its listed factors are "non-exhaustive," adding the new language adds nothing of value (in the appropriate case, for example, a court could already consider whether a bailout was necessary in order to prevent a financial institution from becoming insolvent). In light of its cumulative nature, and its tendency to invite speculation and disparity, the proposed amendment is unwarranted.

3. Commentary, Application Notes, 12(B) (Subsection (b)(15)(B)(ii))

The Commission also seeks comment on proposed changes to Application Note 12(B).[80] For similar reasons set forth above with respect to Subsection (b)(15)(B)(i), the NYCDL does not support this amendment to the Application Notes, as it is ambiguous, will result in speculative and variable sentencing findings, and will require the expenditure of additional investigatory and judicial resources to apply.

(D) Impact of Loss and Victims Tables in Certain Cases

1. Limiting the Impact of the Loss and Victims Tables: Issue for Comment 1

The Commission has observed that cases sentenced under § 2B1.1 involving relatively

[80] The proposal adds the following to the end of Note 12(B)(ii): "(VII) One or more of the criteria in subclauses (I) through (VI) was likely to result from the offense but did not result from the offense because of federal government intervention."

large loss amounts have relatively high rates of below-range sentences (both government sponsored and non-government sponsored), particularly in the case of securities fraud and similar offenses. Following receipt of public comments and review of judicial opinions suggesting that the impact of the loss table or the victims table (or the combined impact of the loss and victims tables) may overstate the culpability of certain offenders, the Commission is studying whether it should limit the impact of the loss table or victims table (or both) in such cases sentenced under § 2B1.1 involving relatively large loss amounts.

The NYCDL applauds the Commission's efforts in this regard and believes that the Commission is right to explore and adopt methods for limiting the impact of these tables, which are the source of much criticism for their contributions to disproportionately harsh sentencing guidelines ranges. Judge Rakoff described these ranges, and the sentences they may produce, as the "travesty of justice that sometimes results from the guidelines' fetish with abstract arithmetic," and noted "the harm that guideline calculations can visit on human beings if not cabined by common sense."[81] Others have alluded to the framework leading to such results as, more simply, "of no help."[82]

Examples abound in which an excessive emphasis on mechanical Guidelines calculations leads to an unnecessarily severe advisory Guidelines range for a defendant who committed an economic offense.[83] The Second Circuit has observed that the Guidelines calculations for white-collar offenses may result in sentences "longer than [those] routinely imposed by many states for

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81 *Adelson*, 441 F. Supp. 2d at 512.

82 *United States v. Watt*, 707 F. Supp. 2d 149, 151 (D. Mass. 2010).

83 *See* David Debold & Matthew Benjamin, Essay, *"Losing Ground"—In Search of a Remedy for the Overemphasis on Loss and Other Culpability Factors in the Sentencing Guidelines for Fraud and Theft*, 160 U. PA. L. REV. PENNUMBRA 141, 142 (2011) (noting that increased Guidelines ranges driven by loss and combined with duplicative enhancements "have escalated advisory guidelines sentences for high-loss frauds beyond those once reserved for violent criminals"); *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).

violent crimes, including murder, or other serious crimes such as serial child molestation."[84] Indeed, "virtually every judge faced with a top-level corporate defendant in a very large fraud has concluded that sentences called for by the Guidelines were too high."[85] The Guidelines ranges that give way to these extreme sentences base the offense level for economic crimes on the pecuniary loss resulting from the crime – an amount that is often speculative, imprecise, and highly-contested. For economic offenses, this flawed process is rooted in the loss table and compounded by the victims table, which often produces Guidelines ranges that *exceed* even the statutory maximum for the offense at issue.[86]

Where there is no correlation between loss to the "victims" and gain to the defendant, the loss table drives an illogical and unjust result, and courts historically have departed downward on this basis in cases where the defendant's gain was a tiny fraction in relation to the total alleged loss.[87] "The type of case that falls into the 'heartland' of cases contemplated by the Guidelines for theft of property is 'where loss and gain are roughly coincident.'"[88] However, "where the defendant is not the principal, where he or she is a functionary, loss to the victim and gain to the

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84 *United States v. Ebbers*, 458 F.3d 110, 129 (2d Cir. 2006), *cert. denied*, 127 S. Ct. 1483 (2007).

85 Frank O. Bowman III, *Sentencing High-Loss Corporate Insider Frauds After* Booker, 20 FED. SENT'G REP. 167, 169 (2008).

86 *See, e.g.*, *United States v. Stephen*, 440 F. App'x 824, 826 (11th Cir. 2011) (guidelines range of 235 to 293 months exceeded statutory maximum of 20 years' imprisonment in mail fraud case); *United States v. Botts*, 135 F. App'x 416, 417-18 (11th Cir. 2005) (loss calculation resulted in guidelines range of 151 to 181 months, triple the 60-month statutory maximum); *Watt*, 707 F. Supp.2d at 151 ("[I]f not for the statutory maximum [of 5 years' imprisonment], the Guidelines for an offense level 43 and criminal history I would have called for a sentence of life imprisonment."); *Adelson*, 441 F. Supp. 2d at 509, 511 (guidelines calculation for first-time offender convicted of securities fraud was a draconian 85 years' imprisonment).

87 *See, e.g. United States v. Redemann*, 295 F. Supp. 2d 887, 889 (E.D. Wisc. 2003) (downward departure warranted where "defendant's fraud may have been for little or no gain, especially in comparison to the size of the loss").

88 *United States v. Costello*, 16 F. Supp. 2d 36, 39 (D. Mass. 1998). In *Costello*, the district court found that the following facts were significant in determining that a downward departure was appropriate: (1) that the defendants did not come up with the scheme at the outset; (2) that another defendant initiated the idea and had the purported contacts willing to fence the stolen merchandise; (3) that the defendant's profit, at least in the first transaction, was minuscule compared to the value of the materials stolen; and (4) that the defendant's cut was less than one percent of the value assigned by the government to the stolen goods ($20,000,000). *Id.*

defendant are not comparable."[89] The issue is a matter of degree: the extent of disproportion between the loss to the victim and the gain to the defendant.[90]

The need for reform is underscored by the fact that the Guidelines' loss and victims tables, in their current forms, advance neither the Commission's nor Congress's sentencing goals in white-collar cases. The exaggerated effect on sentencing of the current loss and victims tables is inconsistent with the Commission's aim to "ensure a *short but definite* period of confinement for a larger proportion of these 'white collar' cases, both to ensure proportionate punishment and to achieve adequate deterrence."[91] These inflated guidelines ranges caused by substantially overlapping enhancements must be addressed to answer Congress's call for securities fraud penalties that "appropriately account for the potential and actual harm to the public and the financial markets."[92]

a. *Limiting Impact of Loss Table if the Defendant Had Relatively Little Gain Relative to the Loss*

The NYCDL believes the Commission should limit the impact of the loss table in cases involving large loss amounts if the defendant had little gain relative to that loss, and that this may be best accomplished in the form of a downward adjustment that would allow the sentencing judge to consider factors, such as individual culpability and the type of gain, rather than through a specific offense characteristic that focuses only on specific dollar amounts.

The Commission proposes that a new specific offense characteristic should be inserted to limit the impact of the loss table in cases involving large loss amounts if the defendant had relatively little gain relative to the loss.[93] For example, if the defendant's gain resulting from the

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89 *Id.*

90 *Id.*

91 FIFTEEN YEARS, *supra* note 5, at vii (emphasis added).

92 Dodd-Frank Wall Street Reform and Protection Act, Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010).

93 This proposal would apply in insider trading cases under § 2B1.4. Under the current version of § 2B1.4, if

offense did not exceed $10,000, the adjustment from the application of sub-section (b)(1) shall not exceed 14/16 levels. Thus, the proposed specific offense level would cap the increase in levels based on the defendant's gain. The Commission proposes that the maximum gain amount in the specific offense characteristic correspond to one percent of the maximum loss amount. The NYCDL does not believe that this approach is the right approach to address the impact of the loss table.

First, the NYCDL believes that the suggested caps on the increase in offense levels are too high. Under the Commission's proposal, a defendant with a gain of $10,000, $25,000, or $70,000 will not receive an enhancement in excess of 14/16, 16/18, and 18/20 levels respectively. However, even under this proposal, defendants will receive severe enhancements for relatively minor gains. Consider Example 3, where a defendant's gain resulting from the offense did not exceed $70,000 and thus the adjustment from application of § 2B1.1(b)(1) would not exceed 18 levels. This would result in a defendant, who may have gained only $25,001 as a result of his participation in a $7,000,000 fraud, having his base offense level of 6 or 7 increased by 18 levels. On its face, this result seems wildly disproportionate to that defendant's culpability, especially in contrast to a defendant who not only caused a loss amount of more than $2,500,000 but also gained that full amount, who would have his base offense level increased by the same 18 levels. In addition, the decision to set gain as one percent of loss creates a threshold that is simply too low to yield meaningful results in all cases.

The new specific offense characteristic proposal is also lacking for some of the same reasons the loss table is inadequate: it takes an overly-formulaic approach that cannot possibly account for the varied and complex factual scenarios that each individual case presents, scenarios

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the gain resulting from the offense exceeds $5,000, the base offense level is increased as provided for by the table in § 2B1.1.

best left to the discretion of the sentencing judge. For example, in a large bank fraud, if a principal's gain is equivalent to the loss amount, then it makes sense for him to be charged with the full amount of the loss. However, if a lower level employee at the principal's firm was also involved in the fraud but only gained indirectly through his receipt of salary and bonuses from his employment at the firm, it overstates such defendant's culpability to charge him with the full amount of the loss or even a capped amount in the range contemplated by the Commission's proposed amendment.

Moreover, in insider trading cases, while the gain in an insider trading scheme may be large, a defendant may only receive a fraction of the overall gain.[94] In the so-called "expert networking" insider trading cases, for example, some defendants were paid a relatively modest monthly or even hourly fee in exchange for the information used by hedge fund managers to reap large financial gains. In such cases, the current proposal would punish such individuals to a greater degree than their culpability warrants. Consider the following hypothetical: The principal actor in a fraudulent scheme defrauds victims of $2,600,000, resulting in $2,600,000 in illicit gains in the process. The current loss table would increase her base offense level by 18.[95] Because she realized a significant gain from her offense, the new specific offense characteristic, as proposed, would do nothing to alter her guidelines range. A secondary actor in the same fraudulent scheme, an employee of the principal actor, was aware of the scheme but only played a ministerial role in effectuating it. His financial benefit was indirect in that he received nothing more than a bonus of $50,000, which the government alleges was payment for participating in the scheme. The current loss table would subject him to the same offense level increase as the

[94] *See, e.g.*, *Ex-AMD Employee Longoria Pleads Guilty to Four-Year Insider-Trading Scheme*, BLOOMBERG, July 1, 2011, *available at* http://www.bloomberg.com/news/2011-06-30/ex-amd-employee-mark-longoria-pleads-guilty-to-securities-fraud-scheme.html.

[95] *See* § 2B1.1(b)(1)(J).

principal, which, assuming no criminal history, would result in a recommended guidelines range of 51-63 months' imprisonment. Despite the relatively small amount and indirect nature of the gains realized by this secondary actor, as in the case of the principal actor, the new specific offense characteristic, as proposed, would not change his guidelines range. This is because $50,000 is greater than the one percent of loss figure that would be calculated under the Commission's proposed method; moreover, the method does not account for factors such as the indirect nature of his alleged gains. Furthermore, even if the secondary actor only received $25,900, thus qualifying as a gain of less than one percent of the $2.6 million loss, the effect of the proposed framework would only be to cap his specific offense characteristic enhancement at 18 levels. Assuming a scenario in which no substantial mitigating or aggravating factors exist, the secondary actor's situation remains, at best, unchanged, thus illustrating the disutility of the proposed limitations in their current form.

It cannot be suggested that the conduct of the principal and secondary actors in the scenario above is equally culpable – yet the proposed amendments, in their current form, would yield such a result. It is not unusual to find an employer or ringleader who devises, puts into action, and controls a fraudulent scheme for his own profit, ensnaring less culpable ministerial employees in the web of illegal conduct along the way. The new specific offense characteristic, as proposed, would not account for differences in the roles played by these distinct actors at sentencing and, thus, should not be adopted in its current form.

Concerns regarding the overstatement of culpability in these scenarios would be better addressed by a meaningful downward adjustment where the loss amount overstated a particular defendant's culpability. This would allow the sentencing judge to consider a variety of factors, including but not limited to, the role played by the defendant, and whether the defendant's

alleged gain is direct or indirect in nature. In this way, the sentencing judge could account for differences in culpability that cannot be expressed purely in dollar amounts.[96]

b. *Limiting Impact of Victims Table if No Victims Were Substantially Harmed by the Offense*

The Commission proposes amending the victims table in § 2B1.1(b)(2) to limit its impact if no victims were substantially harmed by the offense. Specifically, the Commission has asked whether it should provide that the 4-level and the 6-level prongs of the victims table apply only if the offense substantially endangered the solvency or financial security of at least one victim. The NYCDL fully supports the Commission's initiative to limit the impact of the victims table if no victims were substantially harmed by the offense, and endorses the Commission's approach of only applying the 4-level and the 6-level prongs of the victims table if the offense substantially endangered the solvency or financial security of at least one victim.

c. *Limiting Cumulative Impact of Loss Table and Victims Table*

The NYCDL believes the Commission should limit, if not eliminate, the cumulative impact of the loss table and the victims table. Independent of the other seventeen specific offense characteristics set forth under § 2B1.1(b), the loss table ensures sufficient – if not excessive – punishment for all fraud offenses, as discussed in greater detail above. Furthermore, in cases involving relatively large loss amounts, the cumulative impact is often that of overlapping specific offense characteristics that double-count an aspect of the offense. For example, large scale fraud, by definition, tends to involve a sizeable group of victims. Thus, the NYCDL believes that the Commission should provide that if the enhancement under the loss

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[96] To the extent that the Commission proceeds with this approach, at the very least, the Commission should increase the number of tiers in the alternative gain table from $10,000, $25,000 and $70,000 to six evenly distributed points between $10,000 and $100,000. It would be inequitable to apply the same enhancement to a defendant who received $25,001 in gain with a defendant who profited $70,000 – almost three times the amount. Providing a wider range of gain amounts at more even intervals ensures that individual defendants receive more appropriate and fair enhancements.

table is above 14 levels, the 4-level or 6-level adjustments under the victims table should not be applied.

d. *Other Suggested Approaches to Address Impact of Loss and Victims Tables*

Rather than focusing on gain as a percentage of loss, a better approach may be to focus on personal gain in relation to the overall gain of the fraudulent scheme. For example, a defendant who realized a personal gain amounting to a small fraction of the scheme's overall gain would have his base offense level enhanced to a lesser degree than a defendant garnering a more significant percentage of the scheme's overall gain.

In addition, the Commission may want to consider introducing downward adjustments similar to those that the NYCDL recommended in connection with the insider trading guidelines. By adding specific offense characteristics that relate specifically to a defendant's culpability (*e.g.*, whether the defendant was not an officer or director, or an organizer, leader, manager, or supervisor of the fraudulent scheme), the Guidelines would yield more appropriate sentences based on the culpability of each individual defendant.

2. Scope of Limitations on Loss and Victims Tables: Issue for Comment 2

The NYCDL believes that, should the impact of the loss and victims tables be limited, the limitation should apply in all cases sentenced under § 2B1.1 and not just a subset of such cases like securities fraud. The overstatement of culpability based on loss amount is by no means unique to securities fraud.[97] Nor is it difficult to imagine additional scenarios in which loss

[97] *See, e.g.*, *United States v. Broderson*, 67 F.3d 452 (2d Cir. 1995) (upholding grant of downward departure where the loss amount resulting from the negotiation of a fraudulent contract overstated the seriousness of the defendant's offense); *Desmond*, 2008 WL 686779, at *2 (granting downward departure in mail and wire fraud case where $14.7 million loss "vastly overstate[d] [the defendant's] culpability"); *Redemann*, 295 F. Supp. 2d at 887 (granting downward departure where the loss amount of $2.48 million resulting from bank fraud substantially exceeded any fair measure of defendant's culpability); *Costello*, 16 F. Supp. 2d at 36 (granting downward departure where the loss amount of more than $20.8 million for stolen goods transported interstate substantially overstated defendants' culpability); *United States v. Jackson*, 798 F. Supp. 556 (D. Minn. 1992) (granting downward departure

amounts would overstate culpability, such as a large-scale health care fraud in which administrative staff is asked by hospital administrators and/or doctors to falsify medical records. In all such scenarios, a rigid loss calculation will overstate culpability and, as such, the impact of the loss and victims tables should be limited accordingly.

3. Proportionality: Issue for Comment 3

The NYCDL believes that, should the impact of the loss and victims tables be limited, it would be worthwhile to explore how to adjust the Guidelines that reference those tables to ensure that proportional changes are made.

II. PROPOSED AMENDMENT: CATEGORICAL APPROACH

(A) Commentary on Four Options for Types of Documents: Issue for Comment 1

The Commission has proposed four different options as guidance for the courts in determining whether a prior conviction falls within a category of offense for purposes of a Guidelines conviction. The NYCDL supports Option A, the option that most closely adheres to the "modified categorical approach" adopted by the Supreme Court in *Taylor v. United States*[98] and *Shepard v. United States*.[99]

The "modified categorical approach" developed in *Taylor* and *Shepard* was intended to provide a "pragmatic" approach to determining the nature of a prior conviction "that avoids subsequent evidentiary enquiries into the factual basis for the earlier conviction."[100] In *Taylor*, the Court reasoned that Congress had not intended for courts "to engage in an elaborate factfinding process regarding the defendant's prior offenses," especially since "the practical

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where defendant was deemed a minimal cause of the loss amount of $1.4 million resulting from submitting a false real estate appraisal).

[98] 495 U.S. 575 (1990).

[99] 544 U.S. 13 (2005).

[100] *Id.* at 20.

difficulties and potential unfairness of a factual approach are daunting."[101] The restrictions developed in *Taylor* and *Shepard* reflect those policy judgments.

The NYCDL believes that the policy judgments made in *Taylor* and *Shepard* were the correct ones, and that the Guidelines should restrict and narrow the range of sources to which a court can look in determining the nature of the prior conviction. To promote consistency and reliability in sentences, courts need clear guidance on what documents are appropriate for considering whether a prior conviction fits within a particular category. Option A, which most closely mirrors the *Taylor* and *Shepard* analysis, best meets that goal by giving courts an unambiguous list of specific documents, with some circumscribed flexibility if those particular documents are unavailable.

The goal of both *Taylor* and *Shepard* was to ensure that the determination of whether prior convictions trigger certain sentencing enhancements is based on reliable, uncontested information. Options B, C, and D allow for less reliable sources of information to be considered, leading to inconsistent and variable outcomes. Especially when convictions occurred many years in the past and the facts surrounding the conviction are consequently extremely difficult to reconstruct, the most reliable method is to limit the inquiry to documents that are plainly uncontested and reliable.

The fourth factor of Option A, namely, "some comparable judicial record of this information," already provides enough leeway for the courts to look outside the specifically enumerated sources when circumstances warrant. Options B, C, and D all contain additional language that have the potential to expand and unnecessarily complicate the inquiry. For instance, whether some source is "uncontradicted" or "internally consistent," as described in Option B, could easily become a point of dispute between the government and the defendant,

[101] *Taylor*, 495 U.S. at 601.

leaving the Court without clear guidance on whether to consider the disputed source of information. The same could be said for "sufficient indicia of reliability to support its probable accuracy" in Option C – a phrase that leaves much to interpretation.

Moreover, Option A is the best choice if for no other reason than that it harmonizes with the existing Supreme Court case law regarding statutes. As noted by the Commission, the trend in the Courts of Appeals is to apply the *Taylor*/*Shepard* approach to the Guidelines. There is no reason why the inquiry for Guidelines purposes should differ from that body of law. Indeed, such a deviation would create unnecessary confusion and not advance the Commission's goals in proposing an amendment.

(B) Whether to Apply the Modified Categorical Approach Across the Guidelines: Issue for Comment 2

Because applying Option A to any sentencing enhancement would promote reliability and consistency in sentences, the NYCDL believes it should apply consistently across all the guidelines. To apply Option A selectively to certain offenses, but permit other approaches for other guidelines, would engender confusion and less reliable sentencing findings.

III. PROPOSED AMENDMENT: REHABILITATION

The Commission seeks comments on proposed amendments to § 5K2.19 on "Rehabilitation." Under its current form, § 5K2.19 provides that "[p]ost-sentencing rehabilitative efforts, even if exceptional, undertaken by a defendant after imposition of a term of imprisonment for the instant offense are not an appropriate basis for a downward departure when resentencing the defendant for that offense." The Commission proposes two possible options with respect to § 5K2.19. Option 1 repeals § 5K2.19 in its entirety. Option 2 amends § 5K2.19 to provide that "rehabilitative efforts, whether pre- or post- sentencing, may be relevant in determining whether a departure is warranted." Option 2 also adds commentary to § 5K2.19 that

sets forth a two-part test and the factors for courts to consider in determining whether a departure may be warranted.

The NYCDL supports eliminating § 5K2.19 (Option 1). Alternatively, the NYCDL would support the proposed amendment (Option 2), which provides that rehabilitative efforts may be relevant if present to an unusual degree, although we believe repealing the provision in its entirety would more effectively achieve the Commission's purpose. Notwithstanding past offenses, defendants deserve an opportunity, and should be encouraged, to undertake rehabilitative efforts and courts should be encouraged, not discouraged, from rewarding defendants who seek to become productive members of society. Moreover, proper consideration of this factor may prevent sentences from unduly disrupting a life that is on the road to full rehabilitation.

CONCLUSION

The NYCDL once again wants to thank the Commission for offering us the opportunity to comment on the proposed amendments. We commend the Commission in its efforts to address what the courts and the Commission itself have recognized as advisory guidelines ranges that are inordinately high and harsh. We look forward to continuing dialogue with the Commission as it continues in its efforts to modify the Guidelines as more experience dictates change.

New York, New York
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