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SENTENCING

Off the Chart: The U.S. Sentencing Guidelines Become Increasingly Irrelevant in the Wake of the Market Meltdown

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It is a matter of public record that federal law enforcement authorities are investigating dozens of companies involved in the subprime mortgage industry and related financial market meltdown.[1] At the heart of these investigations is whether those who packaged and sold mortgage-backed securities to investors, or whose balance sheets—and hence share value—incorporated a significant amount of mortgage-backed assets, misrepresented the value of these instruments after they knew them to be in substantial jeopardy. These investigations involve the trading of millions of mortgage-related securities and entail corresponding losses amounting to billions of dollars. Consequently, those who are targeted for prosecution and ultimately convicted, including mid- to lower-level participants, face the unenviable—albeit inevitable—prospect that the U.S. Sentencing Guidelines will recommend a custodial range that both starts and ends at life in prison.

The guidelines were designed to ensure that the most egregious securities law violators receive the most severe sentences. As an increasing number of courts have ruled, however, this ethic breaks down where, as with the securitization of mortgage instruments, essentially *every* impending prosecution involves colossal losses, to potentially millions of victims, perpetrated by a disfavored class of offenders. Of course, the U.S. Supreme Court has declared that sentencing courts are no longer moored to the guidelines but instead must calculate and apply them in conjunction with the sentencing factors set forth in 18 U.S.C. § 3553(a). Moreover, certain courts have already questioned the viability and relevance of the guidelines to the sentencing of market-related fraud offenses and, as a result, have substantially varied their sentences from those prescribed by the guidelines.

It is important to examine these decisions—specifically, their assessment that the guidelines have largely become irrelevant to schemes involving publicly traded securities perpetrated by offenders who happen to be officers or directors of public companies—in light

[1] ''FBI Opens Probes of Finance Giants,'' *The Washington Post*, Sept. 24, 2008 (available at http://www.washingtonpost.com/wp-dyn/content/article/2008/09/23/AR2008092302673.html).

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of the fact that courts sentencing defendants in the wake of the market meltdown will invariably confront offenders whose sentencing exposure under the guidelines is quite literally off the chart. That is, not even contemplated by the sentencing table appended to the guidelines. In this environment, counsel must be prepared to advocate for sentencing exposure that comports with Section 3553(a), particularly its mandate that the sentence imposed shall be sufficient, but not greater than necessary, to reflect the seriousness of the offense, to promote respect for the law, and to provide just punishment.[2]

The Inevitability of Substantial Sentencing Recommendations

In 2002, in the wake of the Enron and WorldCom scandals, Congress passed the Sarbanes-Oxley Act (SOX) which, among other things, directed that the U.S. Sentencing Commission toughen sentences for corporate fraud offenders.[3] The commission responded by amending the federal sentencing guidelines, used by courts to determine the appropriate sentencing range for all individuals convicted of a federal crime.[4] Several of the post-SOX amendments that took effect on Nov. 1, 2003, virtually guarantee a substantial guidelines sentence for any market-related fraud committed by a corporate officer.

Post-SOX Amendments. First, the Sentencing Commission increased the base offense level for securities fraud and most other serious fraud offenses by one level, from six to seven.[5] The practical effect of this seemingly small change was to eliminate the possibility of probation for most white collar offenders, since probation is generally not recommended for offense levels above eight. Next, the commission added a third tier to the multiple-victim enhancement found in Section 2B1.1(b)(2), such that there is now a six-level increase for crimes that victimize 250 or more people.[6] Finally, the commission added a new four-level adjustment if the offense involves a violation of securities law and the defendant is an officer or director of a publicly traded company.[7] The net effect of these post-SOX amendments is an 11-point swing in the offense level of virtually every securities fraud defendant, or roughly five years in prison.

Additionally, at least two pre-SOX enhancements are routinely applied in securities fraud cases, further elevating a defendant's offense level and, correspondingly, his recommended sentence. First, the guidelines provide for a two-level increase in a defendant's base offense level if the offense involved ''sophisticated means,''[8] defined as ''especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense.''[9] Second, the guidelines provide for an upward adjustment of a defendant's offense level based on the role he played in committing the offense.[10] If a defendant ''supervised'' anyone else who participated in the crime, he can expect at least a two-level increase in his offense level, and up to a four-level increase if he led more than five people.[11]

Courts Rebel Against Exorbitant Guideline Recommendations

Following *United States v. Booker*, the sentencing guidelines became advisory, and district courts must endeavor to derive a ''reasonable'' sentence under Section 3553(a).[12] Because the guidelines are ''the product of careful study based on extensive empirical evidence derived from the review of thousands of individual sentencing decisions,'' district courts must treat the guidelines as the ''starting point and initial benchmark'' in imposing judgment.[13] However, the sentencing court must also make an independent assessment of the sentencing factors set forth in Section 3553(a), and, as a result, district judges are generally free to impose sentences outside the recommended guideline range, provided they have considered ''the extent of the deviation and [have] ensure[d] that the justification is sufficiently compelling to support the degree of the variance.''[14]

Deference to Sentencing Courts. On appeal, the reviewing court is to apply a ''deferential abuse-of-discretion standard,'' meaning that, if the sentence falls outside an otherwise properly calculated guidelines range, the appellate court ''must give due deference to the district court's decision that the § 3553(a) factors, on a whole, justify the extent of the variance.''[15] It follows that, in financial crimes where the amount of loss is a substantial determinant of guideline sentencing, a district court may nonetheless conclude that, even after according due weight to financial impact, there remains a broad spectrum of culpability dividing defendants, and the sentences actually imposed following consideration of the Section 3553(a) factors may vary widely.[16]

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[2] 18 U.S.C. § 3553(a)(2).
[3] Pub. L. No. 107-204, 116 Stat. 745 (2002).
[4] The U.S. Sentencing Guidelines operate on a point system. Points are assigned to an offense based on numerous factors in order to determine a defendant's ''total offense level,'' which, together with the offender's criminal history, dictates the recommended custody guideline range.
[5] U.S.S.G. § 2B1.1(a)(1).
[6] U.S.S.G. § 2B1.1(b)(2)(C).
[7] U.S.S.G. § 2B1.1(b)(15)(A).
[8] U.S.S.G. § 2B1.1(b)(9).
[9] U.S.S.G. Commentary, Note 8(B).
[10] U.S.S.G. § 3B1.1.
[11] *Id.*
[12] 543 U.S. 220, 245-46 (2005).
[13] *Gall v. United States*, 128 S. Ct. 586, 594-96 (2007).
[14] *Id.* at 597; *accord Rita v. United States*, 127 S. Ct. 2456, 2462 (2007); *United States v. Cavera*, 550 F.3d 180, 189 (2d Cir. 2008) (en banc); *United States v. Jones*, 489 F.3d 243, 250-51 (6th Cir. 2007).
[15] *Gall*, 128 S. Ct. at 591, 597; *see also id.* at 595 (disposing of an ''appellate rule that requires 'extraordinary' circumstances to justify a sentence outside the Guidelines range''); *United States v. Vowell*, 516 F.3d 503, 512 (6th Cir. 2008).
[16] *Cavera*, 550 F.3d at 192.

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In particular, the district court, citing Congress's apparent disdain for corporate predators embodied by the post-SOX amendments to the fraud guidelines, concluded that "we now have an advisory guidelines regime where, as reflected by this case, any officer or director of virtually any public corporation who has committed securities fraud will be confronted with a guidelines calculation either calling for or approaching lifetime imprisonment."

Against this backdrop, on Dec. 9, 2008, the U.S. Court of Appeals for the Second Circuit affirmed the district court's election in *United States v. Adelson*[17] to downwardly depart in a securities fraud prosecution from a recommended life sentence under the guidelines to a term of confinement of 42 months. In so doing, the Second Circuit noted that the district court's proper calculation of the guidelines, coupled with careful consideration of the Section 3553(a) factors in connection with the defendant's commission of a financial offense, was entitled to substantial deference.[18] Quite significantly, in affirming the sentence, the Second Circuit also ratified the district court's view that *Adelson* was "one of those cases in which calculations under the Sentencing Guidelines lead to a result so patently unreasonable as to require the Court to place greater emphasis on other sentencing factors to derive a sentence that comports with federal law."[19]

Following trial, Adelson, the former president of Impath Inc., a publicly traded cancer diagnostic company, was convicted of conspiracy, securities fraud, and filing false periodic reports with the Securities and Exchange Commission. Despite noting an "inordinate" guideline emphasis on the amount of actual or intended loss in fraud cases and the "multiplier effect" on loss associated with revelations of fraud at public companies that have typically issued millions of shares, the district court found that it was compelled to add 24 levels to Adelson's base offense level, corresponding to an intended market loss in excess of $50 million.[20]

Government Pushes for 20 Additional Levels. At sentencing, the government further advocated that six levels be added because the offense involved more than 250 victims, that four levels be added because Adelson was an officer of a publicly traded company at the time of the offense, that four levels be added due to Adelson's leadership role in the offense conduct, that two levels be added because the offense endangered the financial security of a publicly traded company, that two levels be added due to the use of sophisticated means, and, finally, that two levels be added because Adelson had allegedly induced one of his co-conspirators to obstruct justice.[21]

While the district court sustained objections to the obstruction of justice and financial security enhancements, it nonetheless concluded that Adelson's total offense level was 46—corresponding to a life sentence under the guidelines—despite the fact that he had no other discernible criminal history. Noting the "utter travesty of justice that sometimes results from the guidelines' fetish with abstract arithmetic, as well as the harm that guideline calculations can visit on human beings if not cabined by common sense,"[22] the district court proceeded to fashion a sentence that, while taking account of the guidelines, focused more significantly on the factors set forth in Section 3553(a).[23]

First, while Adelson was Impath's president during a portion of the fraud, the district court found that, unlike other executive officers of publicly traded entities who had personally engineered their underlying frauds, Adelson participated in the fraud scheme for which he was convicted because he feared the effects of disclosing the substantial securities fraud he belatedly learned had been committed by others. Second, the court was moved by evidence that Adelson had otherwise led an exemplary life, highlighted by frequent good works and deep humanity. Third, as to deterrence and the need for the sentence imposed to reflect the seriousness of the crime, the court reasoned that, with his reputation ruined by his conviction, it was highly unlikely Adelson would ever again be in a position to engage in similar misconduct, and that entry of a substantial criminal fine and restitution is often an equally if not more significant form of retribution than prison time in financial offenses. In that vein, the court also pointed to the "considerable evidence" that relatively short prison sentences have a strong specific and general deterrent effect on prospective white collar offenders.

Sentence No Greater Than Necessary. As a result, the district court concluded that a prison term of three and a half years was sufficient, and (perhaps more important) not greater than necessary, to comply with federal law. More broadly, and in an approach now expressly endorsed by the Second Circuit, the sentencing court reasoned that, "where, as here, the calculations under the guidelines have so run amok that they are patently absurd on their face, a Court is forced to place greater reliance on the more general considerations set forth in Section 3553(a), as carefully applied to the particular circumstances of the case and of the human being who will bear the consequences."[24]

The district court in *United States v. Parris* recently employed a similar rationale in downwardly varying the sentences of two white collar defendants from life, as mandated by the guidelines, to 60-month prison terms

[17] 441 F. Supp. 2d 506 (S.D.N.Y. 2006).
[18] *United States v. Adelson*, Nos. 06-2738-cr(L), 06-3179(XAP), 2008 WL 5155341, at *1 (2d Cir. Dec. 9, 2008).
[19] *Adelson*, 441 F. Supp. 2d at 506.
[20] *Id.* at 509-10.
[21] *Id.* at 510.
[22] *Id.* at 512.
[23] *See id.* at 512-15.
[24] *Id.* at 515.

for conspiracy, securities fraud, and witness tampering.[25]

Noting the "utter travesty of justice that sometimes results from the guidelines' fetish with abstract arithmetic, as well as the harm that guideline calculations can visit on human beings if not cabined by common sense," the district court proceeded to fashion a sentence that, while taking account of the guidelines, focused more significantly on the factors set forth in Section 3553(a).

At trial, the *Parris* defendants, both brothers and officers of a publicly traded bottled water company, were convicted of a "pump and dump" scheme; that is, of issuing false press releases designed to substantially increase the share price and trading volume of company stock (the shares at issue were penny stocks) to facilitate the defendants' issuance and sale of company shares into the rising market. Given their illicit $2.56 million profit, the defendants' base offense level was increased by 18 levels under the guidelines. Their offense level was further increased by six levels due to the number of victims, two levels because the defendants' fraud scheme involved sophisticated means, four levels because the defendants were officers of a publicly traded company involved in the offense conduct, three levels due to the defendants' leadership role in the offense, and two levels for obstructing justice. At a total offense level of 42, the bottom of the defendants' custodial guidelines range was 30 years, despite the fact that neither defendant had any criminal history.

As with the *Adelson* district court, the court in *Parris* rejected this result, noting that, "if not for the wisdom of the Supreme Court in recognizing the need to free district courts from the shackles of the mandatory guidelines regime, I would have been confronted with the prospect of having to impose what I believe any rational jurist would consider to be a draconian sentence."[26] In particular, the district court, citing Congress's apparent disdain for corporate predators embodied by the post-SOX amendments to the fraud guidelines, concluded that "we now have an advisory guidelines regime where, as reflected by this case, any officer or director of virtually any public corporation who has committed securities fraud will be confronted with a guidelines calculation either calling for or approaching lifetime imprisonment."[27]

Under *Booker* and its progeny, then, district courts are no longer constrained by a "one-shoe-fits-all" approach to white collar sentencing.

Assess Sentence Under Section 3553(a). The court thus undertook to assess under Section 3553(a) whether the 360-months-to-life guidelines range for the Parrises' crimes could in any way be reconciled with other nationwide securities fraud sentences or with the mean sentences imposed for other federal crimes. On the latter issue, the district court, referring to the Second Circuit's statistical compilation of criminal sentences for 2006, noted that the mean terms of imprisonment for essentially all federal crimes, including murder, manslaughter, sexual abuse, robbery, drug trafficking, racketeering, firearms offenses, and pornography/prostitution, were well below the 30 years the Parrises faced for conspiracy and securities fraud.[28] On the former question, the district court, referring to a compendium of securities fraud sentences compiled by the government, noted that, as opposed to the Parrises, only those securities fraud offenders who had caused losses in excess of $100 million and who had failed to cooperate had been sentenced to double-digit (in years) prison terms.[29] Accordingly, as with the *Adelson* district court, the *Parris* court reasoned that a departure, and in many instances a substantial departure, is warranted in white collar cases where fealty to the guidelines constitutes a "black stain on common sense."[30]

Opportunities From Inflated Guideline Recommendations. Under *Booker* and its progeny, then, district courts are no longer constrained by a "one-shoe-fits-all" approach to white collar sentencing. Provided that a sentence is procedurally sound—meaning that it is derived from well-founded findings of fact, a proper guidelines calculation, and a thorough explanation of the Section 3553(a) factors—an appellate court must accord a high degree of deference to the district court's sentencing determination and may not apply its own conception of reasonableness to the trial court's sentencing variance.[31] This presents substantial opportunities to advocate for sentencing variances in securities fraud prosecutions, particularly those likely to emanate from the current market meltdown. It is thus incumbent upon counsel to highlight, as in *Adelson* and *Parris*, how rote application of the guidelines without careful consideration of the qualifying—and often countervailing—sentencing factors set forth in Section 3553(a) can work a substantial injustice in many market-related securities fraud prosecutions.

Section 3553(a) Factors

Given their increasing prominence in the current enforcement environment, following is a discussion of the

[25] 573 F. Supp. 2d 744, 745 (E.D.N.Y. 2008).
[26] *Id.* at 750-51.
[27] *Id.* at 754.
[28] *Id.* at 752.
[29] *Id.* at 753.
[30] *Id.* at 754.
[31] *Gall*, 128 S. Ct. at 595-97; *Rita*, 127 S. Ct. at 2462; *Cavera*, 550 F.3d at 189.

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Section 3553(a) factors most pertinent to securities fraud sentencing, including the nature and circumstances of the offense, the defendant's personal history and character, the purposes of sentencing and kinds of sentences available, and the need to avoid unwarranted sentencing disparities.[32]

Nature and Circumstances of the Offense. While the amount of loss to the investing public or, alternatively, the defendant's illicit gain is most frequently cited as a proxy for the degree of harm, co-defendants who initiate and are thus jointly and severally liable for a loss or who partake of the same gain are nonetheless often separated, as the courts have held, by widely varying degrees of culpability.[33] Other factors potentially mitigating the seriousness of an offense include whether the defendant devised or was merely an accessory to the scheme, how long he was a participant, his motivation in participating, the foreseeability of the market's reaction, and whether the crime represents recidivist misconduct.

Personal History and Character. Whether a criminal conviction constitutes aberrant behavior in light of an offender's overall history and character is, of course, a key consideration in justifying a substantial variance. Indeed, Ronald Ferguson, the former chief executive officer of General Re Corp., was recently sentenced in the U.S. District Court for the District of Connecticut to a custodial term of only two years, based largely on his personal character (which, aside from his history of good works and numerous character references, included his impending ordination as a minister).[34] This was despite the fact that the district court had previously found the investor loss in the Gen Re case to be in excess of $500 million, resulting in an astronomical increase in Ferguson's offense level under the guidelines.[35] Although sentencing courts are well-equipped to identify pretextual attempts to curry favor, ''if ever a man is to receive credit for the good he has done, and his immediate misconduct assessed in the context of his overall life hitherto, it should be at the moment of his sentencing, when his very future hangs in the balance.''[36]

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Sentencing Purposes. As codified in Section 3553(a), sentencing in federal court serves multiple purposes, including retribution, specific and general deterrence, incapacitation, and rehabilitation. Incapacitation and rehabilitation are inapposite to the vast majority of securities fraud prosecutions, however, given that the fact of conviction roundly disqualifies an offender from future service as a public company officer or director, and that most securities fraud defendants lack sufficient criminal history to warrant rehabilitation at public expense.

Accordingly, the focus under Section 3553(a) in securities fraud prosecutions is on retribution and deterrence, both sentencing objectives that, depending on the facts, may afford substantial downward departure grounds, particularly in light of the kinds of sentences available; i.e., some measure of prison time accompanied by a fine and/or restitution.

In general, the degree of punishment meted out by the courts is a function of the defendant's status as ''principal,'' ''insider,'' or ''gatekeeper'' at the time of the offense (which often corresponds to his access to or control over the facilities and instrumentalities of his criminal conduct), as modified by the fact that substantial fines and restitution orders also provide specific deterrence for many fraud offenders.[37] As to general deterrence, the sentencing court must consider whether similarly situated parties would be deterred independent of the punishment required to facilitate individual deterrence. In practice, this has led the courts to depart

[32] 18 U.S.C. § 3553(a)(1)-(2).

[33] *See Cavera*, 550 F.3d at 192 (''a district court may find that even after giving weight to [a] large or small financial impact, there is a wide variety of culpability amongst defendants and, as a result, [it may] impose[ ] different sentences based on the factors identified in § 3553(a)'').

[34] ''Former Gen Re Executive Gets 2 Years in Prison,'' Associated Press, Dec. 16, 2008.

[35] *Id.*

[36] *Adelson*, 441 F. Supp. 2d at 513-14.

[37] *Id.* at 514; *see also United States v. Cole*, No. 5:08-cr-327, 2008 WL 5204441, at *5 (N.D. Ohio Dec. 11, 2008) (finding that the defendant's insider status afforded him access to material, nonpublic information, the theft of which ''undermine[d] a cornerstone of our investment regulation policy,'' thereby warranting prison time for purposes of both retribution and deterrence).

from the custodial range otherwise dictated by the guidelines in light of significant evidence that even comparatively short prison terms in white collar cases, coupled with a significant fine, can have a substantial deterrent effect on similarly situated individuals.[38]

Avoiding Sentencing Disparities. Finally, while adherence to the guidelines is, for many federal crimes, a fundamental means of ensuring consistency in sentencing, this precept is essentially inapt in securities fraud prosecutions where the principals of Enron and WorldCom were exposed to largely the same guideline considerations and enhancements as the current leaders (particularly post-SOX) of any run-of-the-mill penny stock scheme. With regard to sentencing consistency, then, consulting the statistical abstracts maintained by the Sentencing Commission[39] and other data compilations reflecting sentencing outcomes in analogous cases (even if purely anecdotal) is certainly advisable. However, unless the guidelines are ever amended to bracket application of the post-SOX enhancements to certain categories of fraud offenses or there is some form of judicial or legislative effort to track departures in securities fraud prosecutions, achieving consistency in the rate and degrees of variance from the otherwise applicable guidelines range will more than likely have to come from effective advocacy in connection with collateral Section 3553(a) sentencing factors.

[38] *Adelson*, 441 F. Supp. 2d at 514; *Cole*, 2008 WL 5204441, at *7.

[39] *Id.* at *8; *Parris*, 573 F. Supp. 2d at 752.

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