

# SECURITIES LITIGATION & REGULATION

## EXPERT ANALYSIS

### Cooperation Continues to Pay

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We have previously studied years of criminal sentences and civil penalties to assess whether cooperating with authorities provided tangible benefits in insider-trading cases. The results were clear: It did. Cooperators received markedly lower prison sentences and civil penalties. The trend held true in 2013. Nowhere does the pattern hold more true than in the Southern District of New York, the epicenter of the U.S. government's insider-trading enforcement efforts.

#### COOPERATION 101

When assessing individuals' cooperation, the Securities and Exchange Commission engages in a multi-part analysis, during which those individuals can only control one factor: the amount of assistance they provide.<sup>1</sup> To weigh this, the SEC looks to the value and the nature of the cooperation, considering factors like the timeliness and voluntariness of the cooperation and the benefits it provides to the SEC. The Department of Justice similarly considers an individual's cooperation when deciding whether to move for a downward departure at sentencing.<sup>2</sup> Likewise, the federal Sentencing Guidelines also focus on the timeliness and comprehensiveness of the defendant's assistance.<sup>3</sup>

Entities may cooperate as well. Authorities determine whether the organization practiced sufficient self-policing, self-reported fully and accurately to authorities, took appropriate remedial action, and assisted authorities on an ongoing basis during their investigation.<sup>4</sup>

#### COOPERATORS RECEIVED LESS PRISON TIME, IF ANY

A review of insider-trading sentences over the past four years reveals that convicted cooperators routinely receive no prison time. This trend was nearly the rule in 2013. Of the 15 cooperators sentenced last year, 11 received no prison time, and the longest prison sentences received were for one year on pleas with minimum sentencing guideline recommendations of nearly six years, and over eight years, respectively.

In contrast, 12 sentences were handed down to non-cooperators in insider-trading cases in 2013. These prison sentences averaged slightly over three years. Only two non-cooperators received no prison time, and they were both outside of the Southern District of New York. The five non-cooperating defendants in the Southern District of New York, including two guilty pleas and three trial verdicts, all received prison sentences of at least one year and averaged about three-and-a-half years.

The aggregate data from the past four years reflects the same trends, with cooperators faring better than defendants who entered guilty pleas, even though the cooperators' recommended Sentencing Guidelines range was higher. Specifically, cooperators received an average sentence equal to



*Non-cooperating defendants who entered guilty pleas fared better on average than those who went to trial.*

10 percent of the minimum recommended guidelines range. In contrast, non-cooperating defendants who plea-bargained received sentences equal to 70 percent of the minimum recommended guidelines range, and defendants who went to trial received average sentences equal to 64 percent of the minimum guidelines range.

Not every insider-trading matter is a mega-case, so we considered whether a few large matters skewed the numbers. They do not. Each insider-trading sentence from 2010 through 2013 deviated from a rough average of half the minimum guideline. In 2013 we continued to see cooperators receive consistently below-average sentences that typically involved no prison time. And, while prosecutors continued their success in securing guilty verdicts, the prison sentences that followed trial varied from no prison time for one defendant, to a maximum of 86 percent of the minimum guideline.

Non-cooperating defendants who enter a plea of guilty continue to receive a wide range of sentences. It is worth noting that the one defendant to receive a sentence longer than the minimum guideline, John Kinnucan, may represent the antithesis of a cooperator. The press release announcing his sentence said his “criminal odyssey” had evolved into a “vile and very public campaign to threaten public servants and obstruct the federal investigation,” which included repeated threatening calls to prosecutors and investigators.<sup>5</sup> The release said, “In these telephone calls, Kinnucan made repeated references to genocide, sexual and other forms of violence and threatened physical harm to one of the prosecutors handling this matter. He also made multiple telephone calls to one cooperating witness and attempted to contact another in an effort to intimidate and harass them.”<sup>6</sup>

Kinnucan was sentenced to more than four years in prison. Putting aside this one anomalous case, non-cooperating defendants who entered pleas of guilty fared better on average than those who went to trial. The insider-trading sentences handed down in 2013 show a clear continuation of the trends that have become evident in the past few years. From 2010 through 2013 cooperators consistently received no prison time or substantially reduced sentences. Those found guilty at trial almost always received some prison time, but the amount varied widely from the guidelines recommendation. Non-cooperating plea bargainers occupy the entire spectrum.

### **KNOW YOUR ROLE**

The last four years of sentencing data also leave little doubt that prison sentences are highly dependent on whether the defendant was a “tipper,” a “tippee” or both. This holds true for cooperators and non-cooperators alike. Among cooperators, tippers and defendants who traded and tipped fared better than tippees, who merely traded on and profited from the information leaked by the tippers. All cooperators, however, received substantially less prison time than non-cooperating defendants, regardless of role.

A non-cooperating defendant’s role led to dramatic differences in prison sentences.

The data for 2013, by itself, reflected the same trend even more starkly, with non-cooperating tippers receiving average sentences of less than 15 months, while tippees received over 40 months on average.

### **IF YOU CAN MAKE IT THERE, YOU WILL MAKE IT ANYWHERE**

Prosecutors in and around New York City continue to secure the longest prison sentences for insider trading. Over the past four years, the Southern District of New York has continued to reward cooperation most handsomely as well, with cooperators rarely receiving prison sentences and averaging less than two months of prison time, while non-cooperators average over 30 months of prison time.

Cooperation outside the Southern District of New York still has benefits, but may not be as advantageous. Cooperators outside the district received prison sentences averaging slightly over 15 months, whereas non-cooperators averaged just over 27 months.

There were fewer cooperators outside the Southern District of New York during this period, though (seven, as compared with New York's 28) because there were fewer insider-trading cases brought outside the Southern District of New York.

The data thus likely reflect more of a collection of recent anecdotes than a trend. Nevertheless, insider-trading defendants outside New York City likely face a different calculus than those within New York City.

### A CLEAR FORMULA FOR CIVIL PENALTIES

Although the SEC and courts may impose civil penalties of up to three times the trading profits, this result seems rare. All but two of the civil penalties imposed in civil actions brought by the SEC arose in the context of settlements, and the majority of the settlements involved a penalty equal to disgorgement. The only three-times penalty resulted from a default judgment. Akin to the usual no-jail sentence in criminal cases, cooperators in SEC civil enforcement cases were much more likely than non-cooperators to receive no penalty.<sup>7</sup>

Moreover, many of the other deviations are explainable by unique factors. For example, in 2013, three individual brokerage customers disgorged gains but paid no penalty in a case where the defendant charged with conducting the insider trading and his wife did pay a penalty equal to their personal benefit.

On the other side of the scale stands the \$13.9 million fine imposed on former Goldman Sachs director Rajat Gupta, who was convicted in the Galleon Group hedge fund case, notwithstanding that he had no gains to disgorge from any insider trading. This result shows, as do a couple others where substantial fines were imposed on settling defendants, that the SEC will impose a large civil penalty where the SEC finds it necessary to provide a meaningful disincentive.

### COOPERATORS CANNOT ESCAPE IT ALL

Although cooperators generally receive leniency, their violations are not entirely forgiven. Prosecution, a civil injunction, disgorgement of ill-gotten gains and reputational harm are all near certainties. Indeed, under the SEC's new approach to settlements this year, defendants, perhaps even cooperating defendants, could be forced to admit wrongdoing when settling charges. Plus defendants might find themselves without a job or even barred from the securities industry once the insider-trading charge becomes public.

Cooperators also face substantial demands on their time due to multiple meetings with prosecutors and SEC enforcement lawyers, testifying (and enduring grueling cross-examination) at trials, depositions and hearings, and potentially recording certain conversations with erstwhile friends and co-workers.

### OUR TAKEAWAY

Whether to cooperate always depends on the specific facts of the situation. The statistics suggest that for a defendant with a low likelihood of success at trial, cooperating in a criminal insider-trading investigation, especially within the Southern District of New York, makes good sense.

Cooperating with the SEC seems to almost uniformly result in a reduced civil penalty, if any civil penalty at all. But, the SEC, unlike the Justice Department, suffered a public insider-trading trial loss in 2013, and the civil penalties imposed after trials are not very high. More civil defendants, therefore, might consider taking their cases to verdict.

Nevertheless, insider-trading cases are often about more than the numbers alone; they are human stories filled with personal risks, emotions and circumstances. These subjective factors may drive the cooperation decision as much as any statistical trend.

*From 2010 through 2013 cooperators consistently received no prison time or substantially reduced sentences.*

## NOTES

- <sup>1</sup> See SEC Enforcement Manual at § 6.1.1 (Oct. 9, 2013), available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>. The SEC also considers the importance of the underlying matter, society's interest in holding the individual accountable and the profile of the individual.
- <sup>2</sup> See U.S. Attorney's Manual at 9-27.230 and 9-27.740, available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title9/27mcrm.htm#9-27.600](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/27mcrm.htm#9-27.600).
- <sup>3</sup> See 2013 Federal Sentencing Guidelines Manual at § 5K1.1 (Nov. 1, 2013), available at [http://www.uscourts.gov/Guidelines/2013\\_Guidelines/Manual\\_HTML/5k1\\_1.htm](http://www.uscourts.gov/Guidelines/2013_Guidelines/Manual_HTML/5k1_1.htm).
- <sup>4</sup> See SEC Enforcement Manual, *supra* note 1, at § 6.1.2.
- <sup>5</sup> See Press Release, U.S. Attorney's Office, Southern District of New York, Oregon-Based Research Consultant John Kinnucan Sentenced in Manhattan Federal Court to 51 Months in Prison for Insider Trading Scheme (Jan. 15, 2013), available at <http://www.fbi.gov/newyork/pressreleases/2013/oregon-based-researchconsultant-john-kinnucan-sentenced-inmanhattan-federal-court-to-51-months-inprison-for-insider-trading-scheme>.
- <sup>6</sup> *Id.*
- <sup>7</sup> The information presented here excludes announced SEC settlements for which penalties were yet to be determined as of year-end.



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