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HEADLINE: PLEA BARGAINING IN SECURITIES CASES

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HIGHLIGHT: Harsh Sentences under Federal Guidelines, the Threat of RICO Prosecution, and Leniency Offered to Defendants Who Cooperate Put Pressure on Securities Defendants to Plead Guilty Quickly. In an Appendix, the Author Summarizes the Sentences and Other Outcomes for Securities Defendants in the Southern District of New York.

"The train is leaving the station." This old saw has for generations been a staple of the pitch by prosecutors to induce a potential defendant to plead guilty or to cooperate with the authorities. In criminal securities fraud cases, as in many other criminal cases, defense counsel have long understood the importance of making a judgment early in an investigation as to whether to prepare for a possibly long and furious fight or to wave the white flag before hostilities have escalated.

Several recent changes in the law as well as emerging patterns in sentencing practices have forced an acceleration of the decision-making process for anyone faced with criminal securities fraud charges, whether for insider trading, stock manipulation, or the more esoteric tax and regulatory offenses that arise from what is generically known as stock "parking." Making the decision whether to plead on an accelerated timetable is not easy. In most cases, time is short, emotions run high, information is scant, and a career is at stake.

The need to make the decision as early as possible arises from several factors. First, the Federal Sentencing Guidelines provide many inducements to plead guilty, and to do so early on.[1] Second, the specter of a RICO prosecution—against an individual or a firm—with pretrial restraints on assets and post-conviction forfeitures, provides an incentive to plead guilty to lesser offenses to avoid this severe sanction. Third, a defendant considering a guilty plea should also think about cooperating with the government's investigation. Comparing sentences in the last decade in securities fraud prosecutions brought by the U.S. Attorney's Office for the Southern District of New York reveals a striking disparity between sentences given to defendants who have cooperated with the authorities and to those who have not. Whether this disparity should exist is debatable; that it does exist is undeniable, and it is likely to become more pronounced as the Sentencing Guidelines permit those who provide "substantial assistance" to the authorities to escape altogether from harsh Guidelines sentences. Fourth, the proliferation of parallel civil and administrative proceedings increases the importance of an early balancing of the civil consequences of admitting to criminal wrongdoing against the civil consequences of asserting the constitutional right not to be a witness against oneself.

Of course, a prospective securities fraud defendant will want to keep in mind that appellate review provides some level of protection. The recent spate of reversals of securities fraud convictions in the Second Circuit may give a potential defendant pause before pleading guilty.[2]

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[1] However, as described below, the Guidelines provide draconian sentences for many securities offenses that shift the risk-benefit calculus away from acceptance of a determinate sentence toward a willingness to roll the dice on an all-or-nothing result.

[2] *See, e.g.*, *United States v. Mulheren*, Dkt. No. 90-1691 (2d Cir., July 10, 1991); *United States v. Regan*, Dkt. No. 89-1591 (2d Cir., June 28, 1991) (as amended July 17, 1991); *United States v. GAF Corp.*, 928 F.2d 1253 (2d Cir. 1991).

THE SENTENCING GUIDELINES

Congress enacted the Sentencing Guidelines to bring greater uniformity and determinacy to the federal sentencing process. The Guidelines have led to harsher sentences for almost all offenses and have greatly reduced the ability of federal district court judges to temper justice with mercy based on individual circumstances.[3] The Guidelines make it far more likely than in the past that the typical criminal securities defendant—a first-time offender with family and community ties—will receive a term of imprisonment.[4] For securities fraud schemes that involve millions of dollars, the period of incarceration is likely to be substantial.

The Guidelines set forth a points system that gives a defendant a certain number of points (or a given "base offense level," in Guidelines parlance) for the seriousness of the offense, and adds points for aggravating factors, role in the offense, obstruction of justice, and the like. Certain mitigating factors can reduce the offense level, and there are limited specified grounds that permit a sentencing judge to depart from the Guidelines in determining an appropriate sentence. Once the adjusted offense level has been calculated, the sentencing range (in months) is located on a grid that has the offense levels on its vertical axis and the defendant's "criminal history" category (based on prior convictions) on the horizontal axis.

The following example illustrates how the Guidelines would apply to an investment banker who entered a guilty plea after misappropriating material nonpublic information from his or her firm concerning several planned but unannounced corporate takeovers and passing the tips to four friends, each of whom traded in the relevant securities. Assume that the tipper made a $500,000 profit and each tippee turned a $100,000 profit for a combined profit from the scheme of $900,000.

(1) For insider trading, a "base offense level" of eight.[5]

(2) For the "specific offense characteristics"—here, a gross gain from the scheme of $900,000—increase by eleven levels.[6]

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[3] For instance, the Guidelines do not permit a court either to reduce a defendant's offense level or to depart from the applicable guideline range for dependence on alcohol or drugs. U.S.S.G. sections 5H1.4 ("Drug dependence or alcohol abuse is not a reason for imposing a sentence below the guidelines") and 5K2.13 (departure for diminished mental capacity not available if the diminished capacity resulted from voluntary use of drugs or other intoxicants). *See, e.g., United States v. Pharr*, 916 F.2d 129, 132-33 (3d Cir. 1990) (reversing downward departure that the district court had based on effort to overcome heroin addiction); *United States v. Deigert*, 916 F.2d 916, 919 n. 2 (4th Cir. 1991) (drug abuse may not, even under extraordinary circumstances, individually or in combination with personal financial difficulty, support downward departure).

[4] *See* Breyer, *The Federal Sentencing Guidelines and the Key Compromises Upon Which They Rest*, 17 Hofstra L. Rev. 1, 20-21 (1988) (Guidelines require terms of imprisonment for white-collar offenders who previously would have likely received only probation).

[5] U.S.S.G. § 2F1.2(a).

[6] Sections 2F1.2(b)(1) (directing use of "fraud chart") and 2F1.1(b)(1)(L) (gain from the scheme of more than $800,000).

(3) For being an "organizer or leader of a criminal activity that involved five or more participants or was otherwise extensive," increase by four levels.[7]

(4) For abuse of a position of trust, as an investment banker entrusted with information about planned but unannounced takeovers, in a "manner that significantly facilitated the commission . . . of the offense," increase by two levels.[8]

(5) For acceptance of responsibility as evidenced by a guilty plea, reduce the offense level by two.[9]

Assuming no prior convictions, as is generally the case in securities fraud prosecutions, the defendant would fall into Criminal History Category I.[10] The Sentencing Table shows that for an adjusted offense level of 23 (8 plus 11 plus 4 plus 2 minus 2) in Criminal History Category I, the sentencing range would be from 46 to 57 months' imprisonment.[11] By pre-Guidelines standards, that is a stiff sentence in a white-collar case, especially considering that under the Guidelines regime, parole has been eliminated and available good-time credits have been reduced.[12]

Stopping the Investigation Early

The Guidelines thus provide a number of incentives for the target of an investigation to plead guilty as early in the investigation as possible. Perhaps most important, if the prosecutor is not aware of the full scope of the person's activities, an offer to plead guilty may lead to either an end to the investigation or a reduction in the vigor of the investigation. If, for instance, the government does not yet know about additional trading accounts or bank accounts or has not yet identified all allegedly improper trades, the defendant can stay closer to the lower end of the Guidelines' "fraud chart," which adds offense levels based on the gross gain from the fraudulent activity. Similarly, if the government has not yet identified additional co-schemers, the defendant might avoid the additional points for having played an aggravating role in the offense or for the profits earned by these co-schemers. At an early stage of an investigation, a defendant is more likely to be able to obtain a two- or four-point reduction for having been, respectively, a "minor" or "minimal" participant in the offense.[13] An early guilty plea will also almost ensure that the defendant will receive the two-point reduction for "acceptance of responsibility." Although the Guidelines explicitly state that entering a guilty plea does

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[7] Section 3B1.1(a) (aggravating role in the offense).

[8] Section 3B1.3; *see also* Application Note 1 to § 2F1.2 (§ 3B1.3 applies to insiders or their fiduciaries who misuse inside information).

[9] Section 3E1.1(a).

10 Section 4A1.1.

[11] Section 5A.

[12] Pub. L. 98-473, Title II, § 218(a)(5), Oct. 12, 1984, 98 Stat. 2027 (repealing parole provisions as of Nov. 1, 1987), reprinted in Editorial Notes to 18 U.S.C. § 3551 (West 1990); 18 U.S.C. § 3624(b) (credit for good time now limited to 54 days per year).

[13] Section 3B1.2 (mitigating role).

not guarantee a reduction for "acceptance of responsibility" as a matter of right,[14] the two-level reduction is routinely granted following guilty pleas.

"Relevant Conduct"

Of course, a guilty plea does not prevent the prosecutor—or the probation officer who must prepare a pre-sentence investigative report for the sentencing judge—from continuing an investigation of the defendant's conduct. However, once guilt is established, the intensity of a prosecutor's efforts tends to diminish, especially in the case of a defendant who pleads early in an investigation, and it is thus less likely that "relevant conduct" beyond the offense of conviction will come to light. Under the Guidelines, decisions on each of the factors that determine the offense level, and thus the Guidelines range, are made on the basis of all "relevant conduct," not just the conduct encompassed by the offense(s) of conviction.[15] A defendant is responsible not only for all of his or her own ill-gotten gains, but also for those of all co-schemers and co-conspirators. Thus, for a defendant tipper in an insider trading case, the "gross gain" to the defendant on the "fraud chart" includes not only the defendant's illegal trading profits, but also the profits of all tippees.[16] If the government has not yet identified all of the tippees or all the tippees' trading accounts or illegal trades, the tipper has an increased incentive to plead guilty earlier rather than later.

Weighing against all of these Guidelines incentives to cut a deal early in an investigation is the severity of the Guidelines. Even if a defendant can gain all of the advantages of an early guilty plea, he or she may still face a Guidelines range so draconian that a trial—even with a relatively small likelihood of success—becomes the better choice.

But even short of an acquittal or reversal of a conviction, there are ways around the Guidelines. To escape them, counsel should try to "date"-bargain for a plea to a count that charges an offense occurring prior to November 1, 1987, the effective date of the Guidelines. (As time passes, this tactic will be available only in older cases.) If the defendant pleads to even one Guidelines count, all "relevant conduct"—whether pre- or post-Guidelines—is considered in determining a Guidelines range.[17] Similarly, a plea to an offense occurring prior to the November 1, 1989 effective date of a harsher "fraud

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[14] Section 3E1.1(c); *id.*, Application Note 3 (entry of guilty plea prior to trial and truthful admissions about offense and related conduct constitute significant evidence of acceptance of responsibility, but this evidence may be outweighed by conduct inconsistent with acceptance of responsibility); *see, e.g., United States v. Perez*, 915 F.2d 947, 949-50 (5th Cir. 1990) (*per curiam*).

[15] Section 1B1.3 (defining relevant conduct).

[16] Section 1B1.3, paragraph (d) of Illustrations of Conduct for Which the Defendant Is Accountable; section 2F1.2 (Background).

[17] *Ex post facto* challenges to the use of pre-Guidelines "relevant conduct" to enhance a Guidelines sentence face an uphill battle in light of the analysis in numerous holdings that the Guidelines apply to ongoing offenses that straddle the effective date of the Guidelines, *e.g., United States v. McKenzie*, 922 F.2d 1323, 1328 and n. 2 (7th Cir. 1991); *United States v. Story*, 891 F.2d 988, 991-96 (2d Cir. 1989); *United States v. White*, 869 F.2d 822, 826 (5th Cir.) (*per curiam*), *cert. denied*, 109 S. Ct. 3172, 110 S. Ct. 560 (1989).

table" (which increased the offense levels for a given loss or gain resulting from the fraud) should be considered.[18]

In exchange for a plea, counsel should also try to get the government to stipulate to as many Guidelines factors as possible, including the gross gain from the fraud, acceptance of responsibility, and the inapplicability of the "role in the offense" upward adjustments (such as "aggravating role," "abuse of position of trust," and the like). The prosecutor's discretion to stipulate away Guidelines factors is ostensibly limited by the so-called "Thornburgh Memorandum," a directive from the Attorney General that tells prosecutors not to bargain away conduct that is "readily provable."[19] However, what is "readily provable," like beauty, is in the eye of the beholder, and prosecutors still retain ample discretion to make a deal.

Counsel should also attempt to strike a deal on a determinate sentence. Although some U.S. Attorneys' offices, including the Southern District of New York, have traditionally avoided bargaining over sentences, the Federal Rules of Criminal Procedure and the Sentencing Guidelines specifically permit such bargaining, and the Second Circuit recently suggested to prosecutors that they might want to drop their aversion to sentence bargaining as a means of reducing the burgeoning appellate caseload concerning Guidelines arcana.[20]

Finally, a defendant may escape the Guidelines net by invoking a somewhat obscure Guidelines provision that states that if the total dollar loss (or gain) on the fraud chart overstates the "seriousness" of the offense, "a downward departure may be warranted."[21] This escape hatch is available "when a misrepresentation is of limited materiality or is not the sole cause of the loss." For instance, if a misrepresentation in a securities offering enabled a defendant to sell the securities at an inflated value, but the value of the securities subsequently declined in substantial part for other reasons, a downward departure from the Guidelines range would be appropriate. This provision holds little solace for the insider trader who earned a profit from the illicit trade, except for the anomalous situation in which the stock price run-up resulted from factors other than the announcement of the takeover or other corporate event that the defendant knew about in advance.

In sum, the Guidelines provide many incentives to plead early, with the harsh sentences meted out under the Guidelines greatly raising the stakes in the decision whether to plead or put the government to its proof.

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[18] Fed. Sentencing Guidelines Manual, App. C, Amendment 154 (West 1991).

[19] Memorandum to Federal Prosecutors from Dick Thornburgh, Attorney General, Mar. 13, 1989 (reprinted in ABA, Section of Criminal Justice, National Institute, *White Collar Crime 1991*, 748-53).

[20] Fed. R. Crim. P. 11(e)(1)(C); Guidelines section 6B1.2; *United States v. Pimental*, Dkt. No. 90-1537, *slip op*. at 4021, 4027-31 (2d Cir., May 2, 1991).

[21] Application Note 10 to § 2F1.1.

COOPERATION

It is undeniable that cooperating white-collar witnesses fare far better at sentencing time than their cohorts who refuse to help the authorities. As shown below, this has been a fact of life in insider-trading prosecutions in the U.S. District Court for the Southern District of New York, the district that has seen by far the greatest number of such prosecutions. The relief from the Guidelines available to those who provide "substantial assistance" to the government offers a powerful incentive for a prospective securities fraud defendant to become, depending on your view, a "cooperating witness" or a "snitch."

"Substantial Assistance"

Section 5K1.1 of the Sentencing Guidelines provides, "Upon motion of the government stating that the defendant has provided substantial assistance in the investigation or prosecution of another person who has committed an offense, the court may depart from the guidelines." While only the government (not the defendant) may make a "5K1.1 motion," the government may not in bad faith refrain from making such a motion.[22] The typical cooperation agreement further provides that the government will bring the nature and extent of the defendant's cooperation (as well as the facts of the offense) to the attention of the sentencing judge. A cooperating defendant not only escapes the strictures of the Guidelines but also often receives the few kind words from the prosecutor at sentencing that can help to change a sentence from years in prison to months of community service.

Securities Fraud Sentences in the Southern District of New York

Sentencing practice in securities fraud prosecutions in the U.S. District Court for the Southern District of New York shows that sentencing judges place a high premium on cooperation in sentencing this category of white collar offenders. The Appendix lists defendants who have been prosecuted in the Southern District of New York from 1980 to the present for securities fraud (mostly insider trading) and related offenses (mostly mail and wire fraud, tax crimes, perjury, and obstruction of justice). The chart lists the defendant, the defendant's occupation and firm, the disposition of the case, and the date of disposition. Sentences denoted by an asterisk indicate cases in which the defendant entered a plea of guilty and cooperated in the investigation.

Of the more than 100 individual defendants who have been sentenced in the past decade or so, about half of the defendants who entered a plea of guilty and cooperated with the government did not go to prison at all. Perhaps more important, the list of cooperators includes some of the most notorious Wall Street offenders, many of whom received relatively short prison terms given the magnitude of their crimes. At the sentencing of each cooperator, the sentencing judge almost uniformly stated that the sentence would have been far more substantial had it not been for the cooperation rendered by the defendant. Ivan Boesky and Dennis Levine received prison terms of,

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[22] *See United States v. Khan*, 920 F.2d 1100, 1104-6 (2d Cir. 1990), *cert. denied*, 111 S. Ct. 1606 (1991); *United States v. Rexach*, 896 F.2d 710, 714 (2d Cir.), *cert. denied*, 111 S. Ct. 433 (1990).

respectively, only three years and two years despite their having made astronomical trading profits on stolen information. Investment banker Martin Siegel was sentenced to two months' imprisonment despite having repeatedly sold Boesky inside information in exchange for suitcases full of cash. Many other examples tell the same story. One could debate whether these rewards for cooperation are necessary and appropriate or unseemly and excessive. Right or wrong, however, the rewards for cooperation are huge.

Conversely, the chart of securities fraud prosecutions in the Southern District of New York shows that few defendants who did not cooperate avoided a prison term. This tendency was less pronounced in the early to mid-1980s, but became far more apparent as sentencing judges expressed an increased awareness of the magnitude of the problem of insider trading and other forms of securities fraud, and as some cooperators themselves began receiving brief prison terms.

The stakes in striking a bargain are higher now than a decade ago; the Sentencing Guidelines and the prosecutorial and judicial reaction to the Wall Street scandals of the 1980s make it almost certain that a non-cooperating convicted securities defendant will receive a prison sentence.

RICO

It is no news that RICO is a potent weapon. An individual or firm that is the target of a major federal criminal securities fraud investigation must consider the extent to which a plea can ward off a possible RICO prosecution. Although Congress originally enacted RICO in 1970 as a novel weapon in the war against organized crime, by its terms RICO is not limited to mobsters.[23] Rather, it can be and has been used against white-collar defendants who have conducted the affairs of an "enterprise" through a "pattern" of specified unlawful activities.[24] A defendant convicted of "racketeering" under the RICO statute faces not only a severe prison term and fine; he or she also must forfeit to the government all of the proceeds of the illegal activities.[25] The government can also "freeze" a defendant's assets upon indictment, or even sooner under exceptional circumstances, to preserve assets from dissipation pending the outcome of the prosecution.[26]

The use of RICO in securities cases has generated passionate rhetoric on both sides of the issue. For present purposes, however, it suffices to note that no securities fraud defendant in the Southern District of New York has ever had to plead guilty to a RICO charge, no matter how brazen or wanton the government perceived the conduct to be. Michael Milken was indicted under RICO, but was permitted to plead to six non-RICO counts. Drexel Burnham Lambert similarly entered a plea to six non-RICO counts. The defendants in *United States v. Regan*, the "Princeton Newport" case, were tried and

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[23] 18 U.S.C. §§ 1961-63.
[24] 18 U.S.C. §§ 1961, 1962. RICO stands for Racketeer Influenced and Corrupt Organizations.
[25] 18 U.S.C. § 1963(a).
[26] 18 U.S.C. § 1963(d)(a); *see United States v. Regan*, 858 F.2d 115 (2d Cir. 1988) (restraining third-party assets to prevent dissipation of potentially forfeitable assets).

convicted under RICO.[27] The lesson is not that the mere threat of a RICO prosecution should lead a prospective defendant to bow before the government, but rather that RICO has shifted the businessperson's risk-benefit calculus in favor of a plea that eliminates the nearly limitless downside risk of a RICO prosecution. This realization will not always counsel a negotiated disposition; the perceived unfairness may lead to a decision to stand and fight, or, as in any other case, a trial—or, under the current trend, an eventual appeal—may seem sufficiently winnable that a plea is out of the question.

PARALLEL PROCEEDINGS

A person, firm, or corporation facing a potential federal securities fraud prosecution often may encounter simultaneous or successive actions by the Securities and Exchange Commission (SEC); state and local prosecutors; private civil plaintiffs claiming to have been defrauded; and, for the person in the securities industry, self-regulatory organizations such as the National Association of Securities Dealers (NASD) or the stock exchanges. If illegal profits have not been reported, the IRS may also get into the act. Higher profile cases can also attract the attention of congressional committees. Heaven help the target who has some connection with the banking or thrift industry; these days that defendant can also look forward to possible actions by the Office of Thrift Supervision, the Resolution Trust Corporation, or one of the federal insurance corporations (FDIC or FSLIC).

The decision whether to plead or cooperate becomes more complicated with potential or pending parallel proceedings. A guilty plea will likely have a preclusive effect in subsequent civil actions brought by the SEC or by private parties. On the other hand, the assertion in civil litigation (or an SEC or stock exchange investigation) of the Fifth Amendment privilege against self-incrimination may be necessary if a criminal proceeding looms, but may result in liability in the civil action because of the adverse inference that may be drawn. Further, the NASD and the exchanges can bar any of their members that refuse to cooperate with their investigations.

When parallel proceedings exist, motions to stay the non-criminal proceedings can become part of the strategy on both sides of the criminal action. Criminal defendants can seek a stay of related civil actions to avoid the adverse inference of asserting the Fifth Amendment in the civil actions. Conversely, the government may intervene in civil actions—either private actions or those brought by the SEC—and move to stay discovery or trial to prevent the criminal defendant or even an unindicted criminal target from gaining discovery that is broader than that afforded under the Federal Rules of Criminal Procedure.[28]

If a target of an investigation decides to plead guilty, the counts of conviction and the in-court allocution must be chosen with care to minimize collateral damage. Most securities fraud prosecutions can be terminated with pleas to the crimes of conspiracy,

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[27] The U.S. Court of Appeals for the Second Circuit reversed in part the convictions in the "Princeton Newport" case. *United States v. Regan*, n. 2 *supra*.

[28] United States v. Chestman, 861 F.2d 49 (2d Cir. 1988); C*ampbell v. Eastland*, 307 F.2d 478 (5th Cir. 1962), *cert. denied*, 371 U.S. 955 (1963); Fed. R. Civ. P. 24(b) (permissive intervention).

false record-keeping, false filings or false statements to investigative officials, tax evasion, aiding and abetting such crimes, or other offenses that avoid admissions of wrongdoing that could lead to substantial civil damages. It is not only private plaintiffs who can ride the government's coattails to collect large sums from the convicted securities defendant; the SEC can collect triple damages under the Insider Trading Sanctions Act of 1984 (ITSA) and the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA).[29]

Aside from the formal legal consequences, a defendant suffers numerous adverse side-effects from a guilty plea. The loss of self-esteem can be crushing and is often exacerbated by the attendant publicity. The loss of a professional license that often results compounds the blow. The prospect of a fall from prominence can induce the psychological reaction of denial that may delay an admission of guilt. Any defendant-cooperator in a securities case must first admit wrongdoing to a federal judge, confess again to a jury in as many trials as the government cares to bring, and each time endure the emotionally draining and occasionally humiliating experience of cross-examination at the hands of some of the best lawyers in America.

CONCLUSION

The decision whether to enter a plea of guilty is always a painful one for a person used to society's approval and material rewards. The laws and trends described in this article highlight the importance of making this crucial decision whenever possible in the early stages of the government's investigation. If the decision is to fight, then fight on. But if the decision is to plead guilty, the earlier the better.

[29] Although the Double Jeopardy Clause protects against a post-conviction civil penalty that is grossly excessive as compared to the actual loss to the government, *United States v. Halper*, 109 S. Ct. 1892 (1989), it would be difficult to stretch Halper to nullify post-conviction treble penalties under ITSA. *See, e.g., United States v. Marcus Schloss & Co.*, 724 F. Supp. 1123 (SDNY 1989).