Reexamining 'Loss' And 'Gain' In The Wake Of *Dura Pharmaceuticals v. Broudo* — New Ammunition For Securities Fraud Defendants

Over the past several years, the national discussion surrounding federal sentencing has naturally centered around the U.S. Supreme Court's line of cases beginning with *Apprendi v. New Jersey*[1] and ending with *United States v. Booker*.[2] The full impact of those cases remains largely to be seen, as courts and practitioners grapple with a number of critical open questions, including the appropriate interplay between the guidelines and the other sentencing factors set forth in 18 U.S.C. § 3553,[3] the proper standard of proof for guidelines enhancements,[4] and the contours of "reasonableness" in sentencing.[5]

Although the importance of *Booker* is obvious, statistics from the U.S. Sentencing Commission demonstrate that the guidelines remain, at least for now, the primary driver in federal sentencing decisions. In the first nine months after *Booker* was decided, 61.9% of all federal sentences fell within the applicable guidelines range, compared with 64% of sentences in 2001, 65% in 2002, and 69.4% in 2003.[6] Notwithstanding *Booker*, most courts still rely heavily on the guidelines, at least as the starting point in their sentencing analyses. Consequently, while defense counsel search for ways to free their clients altogether from the guidelines' grasp, they must also continue to find creative approaches to minimizing their clients' exposure under the guidelines.

At least with respect to securities fraud prosecutions, another case decided by the Supreme Court in 2005, *Dura Pharmaceuticals, Inc. v. Broudo*,[7] may provide some ammunition for defense counsel searching for such creative approaches. *Dura* created a *Booker*-like stir among the private securities bar. In *Dura*, the Court resolved a circuit split by holding that a private plaintiff claiming securities fraud must allege more than that the price of the security "'*on the date of purchase* was inflated because of the [defendant's] misrepresentation.'"[8] To succeed on a securities fraud claim, a private plaintiff must also allege and prove that the "share price fell significantly after the truth became known"[9] in the market, and that the plaintiff suffered harm as a result of that decline in the share price. After *Dura*, an "'artificially inflated purchase price' is not itself a relevant economic loss."[10]

The holding in *Dura* has significant implications for sentencing in criminal securities fraud cases, which is driven primarily by the "amount of loss" caused by the allegedly fraudulent scheme.[11] In criminal securities fraud cases, the government typically argues that the amount of loss should be measured by the "artificial inflation" in stock price caused by an

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alleged fraud, regardless of whether the fraud was ever publicly disclosed or whether the stock price ever declined as a result of such disclosure. Applying *Dura*, the Fifth Circuit Court of Appeals recently rejected this approach in *United States v. Olis*,[12] holding that principles of loss causation apply in criminal and civil cases alike, and that "there is no loss attributable to a [criminal] misrepresentation unless and until the truth is subsequently revealed and the price of the stock accordingly declines."[13]

This article explores how *Dura* and *Olis* are likely to affect future criminal securities fraud and insider trading prosecutions. Part I discusses *Dura* and the reasons supporting the Court's rejection of the Ninth Circuit's "inflated purchase price" approach. Part II analyzes the Fifth Circuit's holding in *Olis* that sentencing courts must apply "thorough analyses grounded in economic reality,"[14] aimed at determining the economic impact that the "'defendant truly caused or intended to cause,'"[15] "exclusive of other sources" of impact on the price of the security.[16] Part III discusses the potential extension of the principles articulated in *Dura* and *Olis* to the guidelines calculation of the "gain" attributable to insider trading activities. Specifically, the article criticizes the Eighth Circuit's recent determination in *United States v. Mooney*[17] that the "gain" in insider trading cases should be measured by the net profit a defendant realizes from an inside trade, without consideration of what factors may have caused the stock price to rise between the dates of the insider's purchase and sale. The Fifth Circuit's subsequent decision in *Olis* provides a strong basis for arguing that *Mooney* was wrongly decided, and that a defendant's "gain" should include only the marginal increase in value that is actually attributable to the insider's conduct, and should not include increases attributable to unrelated "gyrations of the stock market."[18]

I. Dura's Rejection Of The 'Inflated Purchase Price' Approach

In *Dura*, the plaintiff class of individuals bought stock in Dura Pharmaceuticals, Inc. ("Dura") on the public market between April 15, 1997 and February 24, 1998.[19] During that period, Dura's managers and directors allegedly made false statements concerning the company's profits and the prospects for future approval by the Food and Drug Administration (the "FDA") of its products.

Upon disclosure of the news on February 24, 1998 that Dura's earnings would be lower than previously expected, its shares lost almost half their value, falling from $39 per share to about $21 per share.[20] In November 1998, Dura announced that the FDA would not approve its new product, prompting a further drop in its share price.[21] The plaintiffs argued that, "[i]n reliance on the integrity of the market, [they] . . . paid artificially inflated prices for Dura securities and . . . suffered damage[s] thereby."[22]

This type of allegation, the Supreme Court concluded, was insufficient, standing alone, to satisfy the loss-causation requirement of the Private Securities Litigation Reform Act of 1995 (the "PSLRA").[23] Specifically, the PSLRA requires that "[i]n any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter *caused the loss* for which the plaintiff seeks to recover damages."[24] The PSLRA's loss-causation requirement is not a novel concept; it is consistent with common-law principles of proximate cause[25] and loss-causation, which require that plaintiffs prove that their loss was linked, in a direct and foreseeable way, to the defendant's fraud.[26]

The *Dura* Court recognized that, because a purchaser may sell the "shares quickly before the relevant truth begins to leak out,"[27] a seller's misrepresentation (and the associated inflated share price) does not inevitably lead to a loss, but rather "*might* mean a later loss."[28] Even if the purchaser later resells those shares at a lower price, "that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price."[29] "[A]t the moment the transaction takes place," therefore, "the plaintiff has suffered no loss,"[30] and the most that can be said "is that the higher purchase price will *sometimes* play a role in bringing about a future loss."[31]

For those reasons, and because securities-fraud actions resemble common-law-fraud actions, which have long required a showing that an individual suffered actual economic loss, the Court held that private-securities-fraud plaintiffs may recover damages only when they "adequately allege and prove the traditional elements of causation and loss."[32] Although the Federal Rules of Civil Procedure require only "a short and plain statement of the claim showing that the pleader is entitled to relief,"[33] the mere allegation that the plaintiff class purchased their shares at an artificially inflated price was not adequate to place the defendants on "'fair notice of what the plaintiff's claim is and the grounds upon which it rests.'"[34] Specifically, the *Dura* complaint failed to (1) "claim that Dura's share price fell significantly after the truth became known," (2) specify "the relevant economic loss," and (3) describe "the causal connection . . . between [the] loss and the misrepresentation."[35] The Court concluded that without the requirement that a plaintiff "provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind," the securities laws would become nothing more than "a partial downside insurance policy."[36]

II. Dura's Potential Impact On Guidelines Calculations Of 'Loss' Attributable To Criminal Securities Fraud.

A. The Importance Of 'Loss' Under The Guidelines

The sentencing calculation for fraud-based crimes, including criminal securities fraud, is governed by section 2B1.1 of the guidelines. That section provides a base offense level for fraud-based crimes, which may be increased dramatically depending on various factors, the most significant of which is the "amount of loss" associated with the alleged crime. The guidelines treat the size of the loss as a proxy for both "the seriousness of the offense" and "the defendant's relative culpability."[37] As the amount of loss increases, the offense-level calculation increases, and thus the guidelines sentence increases.[38] For a defendant charged with fraud, the difference between a loss of $0 and a loss exceeding $400 million (the maximum loss identified by the guidelines) can mean the difference between probation and more than 19 years in prison.[39] Consequently, in securities cases, the loss figure looms large both in plea discussions and at sentencing.

The guidelines define "loss" for purposes of this calculation as the "greater of actual loss or intended loss."[40] As a general matter, "actual loss" means the "reasonably foreseeable pecuniary harm that resulted from the offense,"[41] whereas "intended loss" means "the pecuniary harm that was intended to result from the offense . . . includ[ing] intended pecuniary harm that would have been impossible or unlikely to occur."[42] The guidelines provide little guidance to courts with respect to how loss should be calculated, and state that "[t]he court need only make a rea-

sonable estimate of the loss."[43] Courts applying this principle have adopted a variety of estimation methods, relying alternatively on actual loss,[44] intended loss,[45] gain to the defendant,[46] and losses arising from the defendant's relevant conduct[47] as proxies. Some courts have even gone so far as to adopt their own loss figures that differ from those proposed by either party or by testifying experts.[48]

The centrality of the loss figure to the guidelines calculation, combined with the uncertainties surrounding how loss is properly calculated, make this issue a primary source of concern for defendants and their counsel in securities fraud cases. As suggested below, applying the principles articulated by the Supreme Court in *Dura* may help to alleviate some of that concern, at least in certain circumstances.

B. The Fifth Circuit's Reliance On Dura And Rejection Of The 'Inflated Purchase Price' Approach When Calculating Loss Under The Guidelines: *United States v. Olis*

Jamie Olis was sentenced to 292 months in prison in connection with his work as a tax lawyer and accountant at Dynegy Corporation ("Dynegy") on a transaction called "Project Alpha." "Project Alpha was a plan to borrow $300 million and make it appear to the outside world (and in particular to Dynegy's auditor Arthur Andersen) as if the money was generated by Dynegy's business operations."[49] Through the use of a special-purpose entity called ABG Gas Supply, which was owned by Deutsche Bank and Credit Suisse, Project Alpha was designed to generate positive cash flow to Dynegy "from operations" during 2001 and negative cash flow in 2002-05. During 2001, ABG Gas Supply bought natural gas at market prices and sold it to Dynegy at a discount, after which Dynegy sold the gas at market prices, netting $300 million. The plan called for ABG Gas Supply to buy back the gas during 2002-05 at market prices and resell it to Dynegy at above-market prices. The banks would thereby recoup their $300 million investment, plus interest.

On April 25, 2002, following its review of Project Alpha, the Securities and Exchange Commission required Dynegy to restate the cash flow as derived from "financing" rather than "operations." The price of Dynegy stock fell following the restatement. As a result of his role in Project Alpha, Olis was convicted of securities fraud, mail and wire fraud, and conspiracy, and was sentenced to 292 months in prison, three years' supervised release, and a $25,000 fine. "The most significant determinant of Olis's sentence" was the $105 million loss calculated by the district court.[50] "By the district court's reasoning, this added twenty-six levels to his base offense level and alone placed Olis in a punishment range exceeding fifteen years' imprisonment."[51]

In reviewing the propriety of Olis's sentence, the Fifth Circuit began with the principle that "actual loss [under Guidelines section 2B1.1] 'incorporates [a] causation standard that, at a minimum, requires factual causation (often called "but for" causation) and provides a rule for legal causation (*i.e.*, guidance to courts regarding how to draw the line as to what losses should be included and excluded from the loss determination).'"[52] With that principle in mind, the Fifth Circuit held that "[d]istrict courts must take a '*realistic, economic approach* to determine what losses the defendant truly caused or intended to cause.'"[53]

In setting the parameters for such an approach, the court recognized that "[u]seful guidance appears in the applicable principles for recovery of civil damages for securities fraud"[54] and noted, logically, that "[t]he civil damage measure 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."[55] Citing *Dura*, the Fifth Circuit explained that, in the civil context, "there is no loss attributable to a misrepresentation unless and until the truth is subsequently revealed and the price of the stock accordingly declines. Where the value of a security declines for other reasons, however, such decline, or component of the decline, is not a 'loss' attributable to the misrepresentation."[56]

The *Olis* court went on to consider whether such a standard should be applied in criminal cases. The court discussed cases applying the guidelines to securities fraud convictions, noting that although "at first blush" those cases "yield no consistent rule analogizing criminal responsibility with civil 'loss causation,' disparity is often more apparent than real."[57] To illustrate that point, the court broke the reported cases into three groups.

In the first group of cases — "where defendants promoted worthless stock in worthless companies"[58] courts have held that the loss is equal to "the entire amount raised by the schemes."[59] The Fifth Circuit found that such holdings are "neither surprising nor complex, and [are] fully consistent with civil loss causation" given that the stock at issue is in fact "worthless."[60]

In the second group of cases, courts have employed "a 'market capitalization' approach, basing loss on a gross correlation between stock price decline and the revelation of a fraudulent transaction."[61] Although such a methodology "might be at odds with the greater precision required in civil loss causation,"[62] the Fifth Circuit found such cases to be "unenlightening," as the courts' "underlying reasoning is sparse and supporting facts are few."[63]

The final group of cases involves "fraudulent transactions that 'cook the books' and prop up a company's stock but do not [typically] . . . render the company worthless."[64] The Fifth Circuit noted that calculation of loss in these cases requires a particularly "careful analysis," because the "company's stock price is affected before and after the fraud, by numerous extrinsic market influences as well as the soundness of other business decisions by the company."[65] Although noting that courts have applied "somewhat different approaches" to calculating loss in this context, the Fifth Circuit emphasized that each court took "seriously the requirement to correlate the defendant's sentence with the *actual loss caused in the marketplace, exclusive of other sources of stock price decline*."[66]

The Fifth Circuit also recognized four common themes emerging from these cases: (1) "given the time and evidentiary constraints on the sentencing process, the methods adopted in these cases are necessarily less exact than the measure of damage applicable in civil securities litigation";[67] (2) the cases reject the "oversimplified market capitalization measure of damages proffered by the Government in favor of a more nuanced approach modeled upon loss causation principles";[68] (3) "the cases rejected defendants' arguments that attempted to reason away all losses caused by the fraud";[69] and (4) the cases "reflect the importance of thorough analyses grounded in economic reality."[70]

With this background, the Fifth Circuit then considered how the district court had approached Olis' sentencing, noting that the case involved allegations of the more complex, "cook the books" type of scheme. According to the Fifth Circuit, the sentencing court improperly adopted a methodology that "measured gross market capitalization loss rather than actual losses to shareholders,"[71] and refused to consider evidence offered by Olis that showed that "two-thirds of the drop in Dynegy's price occurred either before the revelation of Project Alpha's problems or more than a week after the announcement of the restatement of earnings caused by Project Alpha."[72] The Fifth Circuit held that "[b]ecause the district court's approach to the loss calculation did not

take into account the impact of extrinsic factors on Dynegy's stock price decline, Olis is entitled to resentencing on this factor, subject to the principles just discussed."[73]

At least three critical themes emerge from *Olis* that may prove useful to future defendants in seeking to minimize the guidelines calculation of loss attributable to alleged fraud, and perhaps (as discussed in Part III, below) in minimizing other guidelines calculations, as well:

(1) Although some courts continue to apply the tautological principle that civil standards have no place in the criminal context, the *Olis* court properly acknowledged that, at least with respect to loss calculations under the guidelines, "[t]he civil damage measure should be the backdrop for criminal responsibility";[74]

(2) In recognizing "the time and evidentiary constraints on the sentencing process," the Fifth Circuit nevertheless stressed the "importance of thorough analyses grounded in economic reality" in a sentencing court's guidelines calculations;[75] and

(3) The sentencing court's "'realistic, economic approach'" to Guidelines calculations must be aimed at determining the economic impact that the "'defendant truly caused or intended to cause,'"[76] "exclusive of other sources" of impact on the price of the security.[77]

III. Extending *Dura* And *Olis* To The Calculation Of Insider Trading 'Gain'

The principles underlying *Dura* and *Olis* translate conceptually into other calculations under the guidelines. For example, it is difficult to see why a "'realistic economic approach,'" aimed at calculating the economic impact that the "'defendant truly caused'"[78] should not also be followed in calculating a defendant's "gain" from illegal insider trading, under section 2B1.4 of the guidelines (titled "Insider Trading"). In insider trading cases, the guidelines employ the concept of "gain resulting from the offense"[79] as an alternative measure of loss, "[b]ecause the victims and their losses are difficult if not impossible to identify."[80] Although the guidelines do not expressly define the term "gain resulting from the offense," the Background to section 2B1.4 explains that, "[b]ecause the victims and their losses are difficult if not impossible to identify, *the gain, i.e., the total increase in value realized through trading in securities* by the defendant and persons acting in concert with the defendant or to whom the defendant provided inside information, is employed instead of the victims' losses."[81]

The ambiguity in section 2B1.4, which the Eighth Circuit recently sought to resolve in *Mooney*, is whether the "gain resulting from the offense," referenced in the text of section 2B1.4, is synonymous with "gain" as it is arguably defined in the Background to that section. In addressing that question, the *Mooney* court — working without the benefit of the Fifth Circuit's reasoning in *Olis*, which was decided three weeks later — refused to adopt a realistic economic approach similar to the one applied in *Dura* and *Olis*, choosing instead to cling to an intellectually lazy "brightline rule."[82] As explained below, *Mooney* suffers from a number of legal and practical infirmities, and should not prevent defense counsel from arguing for a more reasoned approach to the calculation of insider trading "gain." To make such arguments, however, it is important to understand the flaws in *Mooney*.

Michael Mooney was vice president of underwriting for United HealthCare Corporation ("United"). In that role, he attended a number of confidential meetings in early 1995 between United and MetraHealth Companies, Inc. ("Metra"), a company that United was seeking to acquire in pursuance of its strategy to acquire health insurance companies. As part of his compensation, Mooney received stock options from time to time and on April 13, 1995, he exercised his right to purchase 20,000 shares of United stock.

On May 17, 1995, just days after attending a four-day due diligence meeting at Metra, Mr. Mooney instructed his stockbroker to sell the 20,000 shares of stock that he had purchased in April. The sale cleared on May 24, and Mooney used part of the proceeds of that sale to purchase call options in United stock. The call options, which were purchased between May 24 and June 14 for a total of $258,283.03, gave Mooney the right to buy a total of 40,000 shares of United stock at $35 a share in the following months of September, December, and January. Mooney subsequently sold his call options at a profit. On July 14, 1995, he sold the September options, and early in October he sold the December and January options. His total return on these sales was $532,482.49.

United's potential acquisition of Metra was first mentioned in the press in a June 21, 1995 *New York Times* article. United issued a press release that same day, confirming its ongoing discussions with Metra, and United's stock price rose 5 percent that day. The stock price rose

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another 6 percent the following day when *The Wall Street Journal* reported speculation about the potential acquisition. On June 26, United announced its agreement to acquire Metra. From June 20 (the day before the *New York Times* article appeared) to July 15, the price of United stock increased from $40.125 to $44.50 per share, and by October 5, it was selling for more than $49.00 per share.

Mooney was convicted of mail fraud, securities fraud, and money laundering arising out of his scheme to defraud United and its shareholders through his May sale of United common stock and his subsequent purchase and sale of United call options, all while in possession of material nonpublic information relating to United's negotiations to acquire Metra. He was then sentenced to 42 months in prison, based in large part on the district court's finding that the gain derived from Mooney's insider trading offenses was $274,199.46 — the $532,482.49 that he realized from the sale of his United call options minus the $258,283.03 that he paid for them. In other words, the district court found that the "gain resulting from" Mooney's illegal purchase and sale of United call options was the total amount of his profit, regardless of whether some or all of that profit was due to factors other than the inside information that motivated Mooney's transactions.

On appeal, Mooney argued that the guidelines calculation of "gain resulting from the offense" should be based on the "market absorption approach" used in civil insider trading cases, including *SEC v. MacDonald*.[83] Specifically, Mooney argued that the market would have reasonably absorbed the "inside information" by June 28, 1995, *i.e.*, within two days of United announcing its acquisition of Metra, and that the information would have been reflected in the market value of his call options on that date. Subtracting the $258,283.03 purchase price of the call options from their June 28 value of $308,750, Mooney contended that the gain resulting from his offense was $50,467.47.[84] He further argued that the proceeds of the subsequent sales in July and October were irrelevant to the gain calculation, because the market had fully absorbed the information by that time.

The Eighth Circuit, sitting en banc, rejected Mooney's arguments by a vote of 10-3. The majority decision was founded on three flawed principles. First, with little analysis or explanation, the court expressed its unwillingness to "incorporat[e] a civil law standard into the interpretation of a sentencing guideline."[85] Second, the court read "gain resulting from the offense" in section 2B1.4 as synonymous with the definition of "gain" in the commentary to that section, i.e., as '"the total increase in value realized through trading in securities by the defendant.'"[86] The court concluded that "the total increase in value" includes increases that may have resulted from factors wholly unrelated to the information that Mr. Mooney wrongfully used in connection with his purchase and sale of the call options.[87] Third, the court eschewed a disciplined economic approach to the gain calculation in favor of "a clear and coherent brightline rule, eliminating the need for extensive factfinding to try to determine when the market has absorbed nonpublic information."[88] Each of those principles flies in the face of the tenets underlying *Dura* and *Olis*.

Just as the guidelines' definition of "gain" is less than clear, "[t]he loss guideline is [also] skeletal."[89] Seeking some clarity on the loss issue, the Fifth Circuit in *Olis* found "[u]seful guidance . . . in the applicable principles for recovery of civil damages for securities fraud."[90] Because those principles are "attuned to stock market complexities,"[91] the Fifth Circuit in *Olis* reasonably held that "[t]he civil damage measure [for loss announced in *Dura*] should be the backdrop for criminal responsibility . . . ."[92] Accordingly, citing *Dura*, the *Olis* court held that a defendant's sentence should not depend on the "impact of extrinsic factors" on the share price.[93]

The Eighth Circuit faced a similar definitional challenge in *Mooney*, but took a very different approach. The term "gain resulting from the offense" is not expressly defined in the guidelines, nor is the meaning of the term elucidated in any reported cases. For that reason, Mooney urged the court to look to the First Circuit's holding in *MacDonald* that, in a civil case, a defendant's '"profits and interest wrongfully obtained'" through insider trading include only the amounts obtained before the sellers could have reasonably obtained access to the material nonpublic information.[94] Although *MacDonald* did not specifically interpret the guidelines term "gain resulting from the offense," the "profits and interest wrongfully obtained" from insider trading obviously bear a close relationship to the "gain resulting from the offense" of insider trading. Accordingly, the relevance of the *MacDonald* discussion to the question before the Eighth Circuit in *Mooney* seems obvious.

Nevertheless, the Eighth Circuit reflexively refused to adopt the *MacDonald* test, because the theory articulated in *MacDonald* "has been characterized as solely remedial in nature in contrast to criminal punishment."[95] The Eighth Circuit found "no support in the guidelines or in judicial decisions for incorporating a civil law standard into the interpretation of a sentencing guideline."[96] However, the *Mooney* majority did not offer any principled basis for its distinction between the civil and criminal standard, nor did it cite any case law, civil or criminal, to support its theory of sentencing. The majority also failed to acknowledge that courts frequently interpret language in a criminal context with reference to interpretations of the same or similar language in a civil context.[97]

Instead, the court supported its holding by explaining that "[t]he use of actual sales to calculate gain provides a clear and coherent brightline rule, eliminating the need for extensive factfinding to try to determine when the market has absorbed nonpublic information."[98] Apparently unconcerned with the need for the "thorough analyses grounded in economic reality"[99] that was the touchstone of the Fifth Circuit's decision in *Olis* and the Supreme Court's holding in *Dura*, the *Mooney* court failed to explain why courts should (and do) consider expert testimony and analysis to determine loss and gain in the civil context, but should forgo that type of fact-finding in a criminal case, when the defendant's very liberty is at stake.

The *Mooney* majority's standard actually *undermines* the policies underlying criminal sentencing, at least as those policies are articulated in the guidelines. Although the majority correctly observed that the commentary to section 2B1.4 appears to define "*gain*" as "the total increase in value realized through trading in securities by the defendant,"[100] the task for the court in *Mooney* was not simply to define "gain," but to calculate the "gain *resulting from the offense*."[101] In that regard, "the offense" was not merely the purchase or sale of the call options, but the *use of a "manipulative or deceptive device or contrivance*"[102] in connection with the transaction. Accordingly, "[t]he 'gain resulting from the offense' is not the gain resulting from the purchase. It is, rather, the gain resulting from the deception."[103] As the *Mooney* dissent pointed out:

> The gain resulting from the deception stops when the deception stops, though there may be later gain (or loss) as the stock market gyrates along, unmolested by any deception. . . . After the market

adjusts to [the disclosure of the inside] information and the deception is ended, the value of the stock will, of course, continue to fluctuate according to the ordinary, legitimate vagaries of the market — with no deception — and thus, no offense under 15 U.S.C. § 78j — involved.[104]

By basing Mooney's sentence on movements in the stock price that had nothing to do with the underlying deception, the *Mooney* majority was "figuratively imposing [a] sentence on the throw of the dice — the ups and downs of the stock market."[105] That contrasts sharply with the Fifth Circuit's approach in *Olis*, which stressed "the importance of thorough analyses grounded in economic reality" in a sentencing court's guidelines calculations.[106]

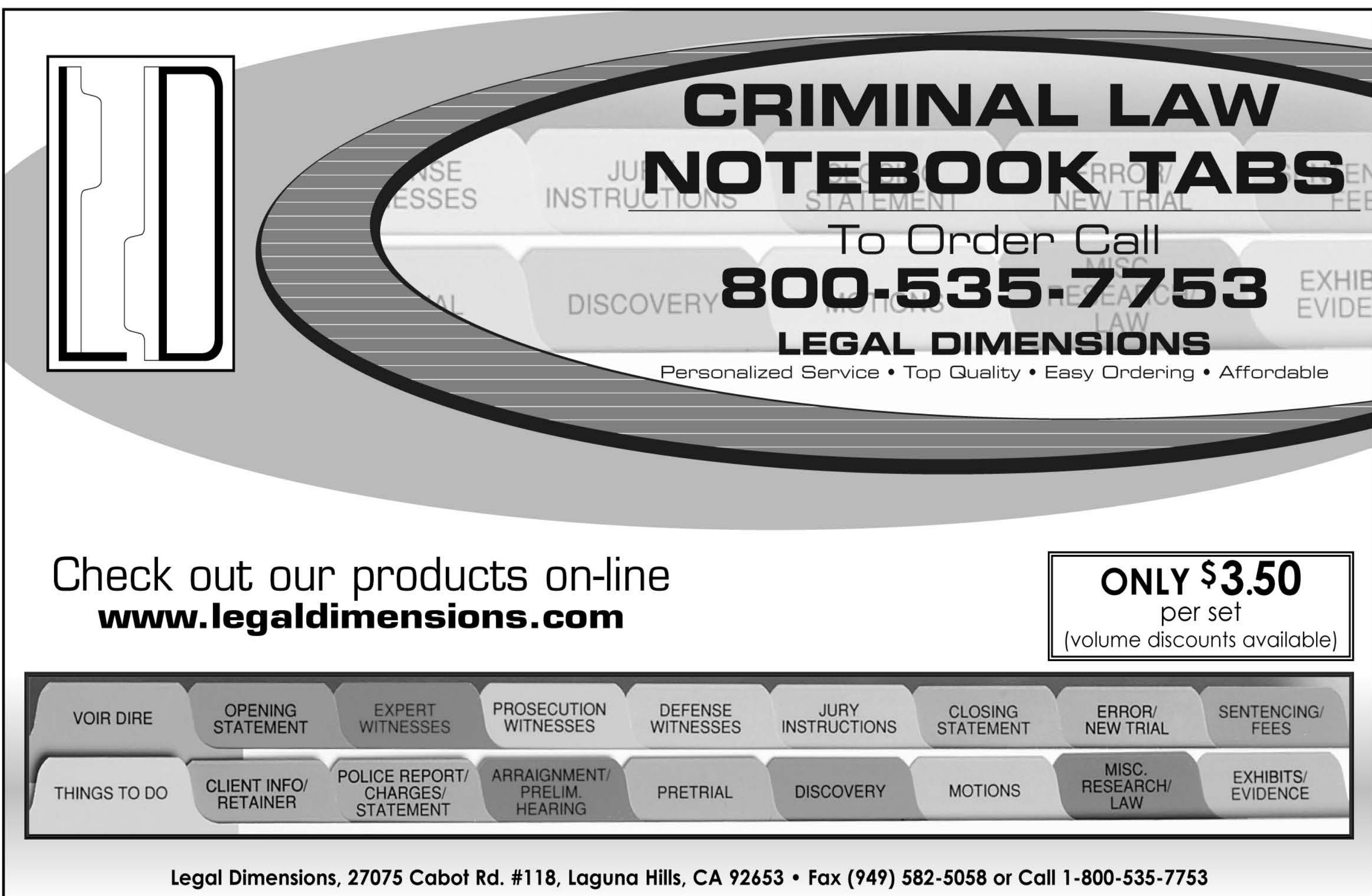
Moreover, the practical effect of the *Mooney* majority's approach will undermine the basic purpose of the guidelines, which is "to move the sentencing system in the direction of increased uniformity,"[107] a uniformity that consists of "similar relationships between sentences and real conduct."[108] The *Mooney* dissent used the following hypothetical to demonstrate that the majority's approach would, far from promoting uniformity, actually result in "unequal sentences for equal crimes."[109]

Assume that Larry, Moe, and Curly are executive officers of a corporation with insider knowledge. They each separately, at the same time, with the same insider's knowledge, buy 1,000 shares of stock at a price of $5.00 per share. Four weeks later, the insider knowledge is made public, and after the fifth week that knowledge has been absorbed by the market and the stock price reflects that knowledge. On the day the knowledge can be said to have been absorbed by the market, the stock price has risen from $5.00 per share to $15.00 per share.

On that day, Larry sells the 1,000 shares he bought, making $10,000 — all of which is illicit gain, arising entirely from his exploitation of insider knowledge. Moe and Curly, whose portfolios on that day reflected the same $10,000 increase in value, each hang on to their 1,000 shares. Three months later, the stock price has soared to $50.00 per share. Moe sells, pocketing total capital gains of $45,000 — including a $10,000 increase from Moe's exploitation of insider knowledge, and a $35,000 increase owing to the ordinary vagaries of the market, untainted by any deception. Curly does not sell for a substantial period of time. Six months later, the market crashes, the stock price plummets, and Curly sells out at $2.00 per share.

Larry, Moe, and Curly committed the same crime, with the same effect on the market. If the "gain resulting from the offense" were the gain from the deception, the guidelines would suggest the same increase (of two levels) over the base offense level for Larry, Moe, and Curly. *See* U.S.S.G. § 2B1.4; § 2B1.1(b). On the [*Mooney* majority's] interpretation, however, Larry would receive a two-level increase, for a $10,000 gain, Moe a six-level increase for a $45,000 gain, and Curly no increase at all, because he lost money on the purchase. *See id.* If these increases were applied to a base offense level of 17 for a defendant with a criminal history category of I, as in Mooney's case, they would translate into additional minimum prison time of six months in Larry's case, a year and ten months in Moe's case, and no additional time in Curly's case.[110]

The goal of uniformity in sentencing is clearly undermined by applying the Guidelines in a way that leads to such disparate sentences for defendants who engaged in identical conduct. "Such an application would create a through-the-looking-glass inversion of the Guidelines — advising unequal sentences for identical crimes — defeating the chief purpose of the Guidelines."[111] While the "realistic economic approach" adopted in *Olis* advances the guidelines' goals of uniformity and fairness, the "brightline" rule applied in *Mooney* sacrifices those goals in favor of expediency.



For all of these reasons, it is difficult to reconcile *Mooney* with the Fifth Circuit's subsequent holding in *Olis*, or with the pragmatic approach adopted by the Supreme Court in *Dura*. Consequently, *Mooney* should not deter counsel from encouraging sentencing courts, when calculating the gain attributable to insider trading, to apply "thorough analyses grounded in economic reality,"[112] aimed at determining the economic impact that the "'defendant truly caused or intended to cause,'"[113] "exclusive of other sources" of impact on the price of the security.[114]

IV. Conclusion

It will presumably take years to resolve the many critical guidelines issues that remain open after *Booker*. In the interim, while sentencing courts continue to pay close heed to the guidelines, defense counsel must search for new ways to minimize their clients' sentencing exposure within the strictures of the guidelines. Citing *Dura* and *Olis*, counsel in securities fraud cases should attempt to persuade sentencing courts to adopt economically disciplined approaches to guidelines calculations, based on the economic impact that the defendant's wrongful conduct actually caused, rather than on extrinsic factors unrelated to the fraudulent conduct. Calculations of loss and gain, notwithstanding the Eighth Circuit's poorly reasoned holding in *Mooney*, are the most obvious examples of when such realistic analyses may lead to greater fairness and uniformity in sentencing.

Notes

1. 530 U.S. 466 (2000). In *Apprendi*, the Court held that "[o]ther than the fact of a prior conviction, any fact that increases the penalty for a crime beyond the prescribed statutory maximum must be submitted to a jury, and proved beyond a reasonable doubt." *Id.* at 490.

2. 125 S. Ct. 738 (2005). In Blakely v. Washington, 542 U.S. 296 (2004), the Court applied *Apprendi* to the state of Washington's determinate sentencing scheme, which was similar to the U.S. Sentencing Commission Guidelines Manual ("Guidelines" or "U.S.S.G."). In *Blakely*, the Court held that "the 'statutory maximum' for *Apprendi* purposes is the maximum sentence a judge may impose *solely on the basis of the facts reflected in the jury verdict or admitted by the defendant*." *Id.* at 303. Under Washington's sentencing scheme, the sentencing court's determination that the defendant acted with deliberate cruelty, as with the determination in *Apprendi* that the defendant acted with racial malice, increased the sentence that the defendant could otherwise have received. Because that fact was found by a judge using a preponderance standard, the Court held that the sentence violated Blakely's Sixth Amendment rights. In *Booker*, the Court applied its *Blakely* reasoning to hold that the mandatory application of the Guidelines similarly violates the Sixth Amendment. The Court remedied that violation by severing and excising two provisions of the Sentencing Reform Act of 1984: 18 U.S.C. § 3553(b)(1), which required courts to impose a sentence within the guidelines range; and 18 U.S.C. § 3742(e), which set forth the applicable standard of appellate review.

3. Because the guidelines are now advisory, in cases sentenced after *Booker*, the guidelines are only one among several factors that sentencing courts must consider in fashioning a sentence that is "sufficient, but not greater than necessary," to achieve the purposes of sentencing set forth in 18 U.S.C. § 3553(a)(2).

4. *See Booker*, 125 S. Ct. at 798 n.6 (Thomas, J., dissenting in part) ("The commentary to § 6A1.3 states that '[t]he Commission believes that use of a preponderance of the evidence standard is appropriate to meet due process requirements and policy concerns in resolving disputes regarding application of the guidelines to the facts of a case.' The Court's holding today corrects this mistaken belief. The Fifth Amendment requires proof beyond a reasonable doubt, not by a preponderance of the evidence, of any fact that increases the sentence beyond what could have been lawfully imposed on the basis of facts found by the jury or admitted by the defendant.").

5. After *Booker*, appellate courts are to review sentencing decisions for "reasonableness." *See Id.* at 765-66. The contours of "reasonableness" remain undefined. In his *Booker* dissent, Justice Scalia posed a number of interesting rhetorical questions:

Will appellate review for "unreasonableness" preserve *de facto* mandatory Guidelines by discouraging district courts from sentencing outside Guidelines ranges? Will it simply add another layer of unfettered judicial discretion to the sentencing process? Or will it be a mere formality, used by busy appellate judges only to ensure that busy district judges say all the right things when they explain how they have exercised their newly restored discretion?

Id. at 795 (Scalia, J., dissenting in part).

6. *See* U.S. Sentencing Commission Special Post-Booker Coding Project 7 (Oct. 13, 2005), *available at* http://www.ussc.gov/Blakely/PostBooker_101305.pdf.

7. 125 S. Ct. 1627 (2005).

8. *Id.* at 1629 (quoting Broudo v. Dura Pharmaceuticals, Inc., 339 F.3d 933, 938 (9th Cir. 2003). Before *Dura*, the circuits were split with respect to the requirements for pleading and proving loss causation in private securities cases. The Eighth and Ninth circuits held that a showing of artificial price inflation satisfied the requirement of loss causation. *See, e.g.,* Gebhardt v. ConAgra Foods, Inc., 335 F.3d 824, 831 (8th Cir. 2003); *Broudo*, 339 F.3d at 937-38. The Second, Third, and Eleventh circuits held that plaintiffs had to show that they bought at an inflated price and suffered an injury due to the defendant's misrepresentation. *See* Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc., 343 F.3d 189, 198 (2d Cir. 2003); Semerenko v. Cendant Corp., 223 F.3d 165, 185 (3d Cir. 2000); Robbins v. Koger Props., Inc., 116 F.3d 1441, 1448-49 (11th Cir. 1997).

9. *Dura*, 125 S. Ct. at 1634.

10. *Id.*

11. *See* U.S.S.G. § 2B1.1.

12. No. 04-20322, 2005 WL 2842077 (5th Cir. Oct. 31, 2005).

13. *Id.* at *5.

14. at *6.

15. *Id.* at *5 (quoting United States v. W. Coast Aluminum Heat Treating Co., 265 F.3d 986, 991 (9th Cir. 2001)).

16. *Id.* at *6.

17. 425 F.3d 1093 (8th Cir. 2005).

18. *Id.* at 1105 (Bright, J., dissenting).

19. See Dura, *125 S. Ct. at 1629.*

20. *See id. at 1630.*

21. *See id.*

22. *Id.* (internal quotation marks and emphasis omitted).

23. 15 U.S.C. § 78u-4.

24. 15 U.S.C. § 78u-4(b)(4) (emphasis added)

25. *See, e.g.,* Citibank, N.A. v. K-H Corp., 968 F.2d 1489 (2d Cir. 1992).

26. *See, e.g.,* Rousseff v. E.F. Hutton Co., 843 F.2d 1326, 1329 n.2 (11th Cir. 1988).

27. Dura, *125 S. Ct.* at 1631.

28. *Id.* at 1632.

29. *Id.*

30. *Id.* at 1631.

31. *Id.* at 1632.

32. *Id.* at 1633.

33. Fed. R. Civ. P. 8(a)(2).

34. *Dura*, 125 S. Ct. at 1634 (quoting Conley v. Gibson, 355 U.S. 41, 47 (1957)).

35. *Id.*

36. *Id.*

37. U.S.S.G. § 2B1.1, comment. (backg'd.)

38. *Id.* § 2B1.1(b)(1).

39. Assuming no other enhancements, a first-time offender involved in a fraudulent scheme resulting in a loss of $5,000 or less faces a Guidelines sentencing range of zero to six months. *See id.* § 2B1.1(b)(1)(A). If the loss exceeds $400 million, that same defendant would be subject to a 30-level increase to the base offense level, resulting

in a guidelines sentencing range of 188 to 235 months. *See id.* § 2B1.1(b)(1)(P).

40. *Id.* § 2B1.1, comment. (n.3(A)).

41. *Id.* § 2B1.1, comment. (n.3(A)(i)).

42. *Id.* § 2B1.1, comment. (n.3(A)(ii)).

43. *Id.* § 2B1.1, comment. (n.3(C)).

44. *See, e.g.,* United States v. Hedges, 175 F.3d 1312 (11th Cir.), *cert. denied*, 528 U.S. 913 (1999).

45. *See, e.g.,* United States v. Piggie, 303 F.3d 923 (8th Cir. 2002), *cert. denied*, 538 U.S. 1049 (2003).

46. *See, e.g.,* United States v. Manas, 272 F.3d 159 (2d Cir. 2001).

47. *See, e.g.,* United States v. Holliman, 291 F.3d 498 (8th Cir. 2002), *cert. denied*, 537 U.S. 1137 (2003).

48. *See, e.g.,* United States v. Grabske, 260 F. Supp. 2d 866, 872 (N.D. Cal. 2002).

49. *Olis*, 2005 WL 2842077, at *1.

50. *Id.* at *2, *5.

51. *Id.* at *5.

52. *Id.* (quoting U.S.S.G. Supp. 2 App. C, Amend. 617 (Nov. 1, 2001)).

53. *Id.* (quoting *W. Coast Aluminum*, 265 F.3d at 991 (emphasis added)).

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.* at *6.

58. *Id.*

59. *Id.* (citing *Hedges*, 175 F.3d at 1314-15 n.6).

60. *Id.*

61. *Id.* (citing United States v. Eyman, 313 F.3d 741 (2d Cir. 2002); United States v. Moskowitz, 215 F.3d 265 (2d Cir. 2000)).

62. *Id.*

63. *Id.*

64. *Id.* (footnote omitted) (quoting John C. Coffee, *Are We Really Getting Tough on White Collar Crime?*, 15 FED. SENT'G REP. 245, 246 (2003)).

65. *Id.* (citing United States v. Snyder, 291 F.3d 1291 (11th Cir. 2002); United States v. Bakhit, 218 F. Supp. 2d 1232, 1238 (C.D. Cal. 2002); *Grabske*, 260 F. Supp. 2d at 869-71).

66. *Id.* (emphasis added); *see, e.g., Grabske*, 260 F. Supp. 2d at 870 (holding that, to demonstrate loss in criminal securities fraud case, "the government must prove that the fraud inflated the price of the stock *and* that the investors 'lost' that inflation after the fraud was revealed").

67. *Olis*, 2005 WL 2842077, at *6.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.* n.13.

72. *Id.* at *6-*7.

73. *Id.* at *7.

74. *Id.* at *5.

75. *Id.* at *6.

76. *Id.* at *5 (quoting *W. Coast Aluminum*, 265 F.3d at 991).

77. *Id.* at *6.

78. *Id.* at *5 (quoting *W. Coast Aluminum*, 265 F.3d at 991).

79. U.S.S.G. § 2B1.4(b)(1).

80. *Id.* § 2B1.4, comment. (backg'd.)

81. *Id.* (emphasis added).

82. *Mooney*, 425 F.3d at 1101.

83. 699 F.2d 47, 53-55 (1st Cir. 1983) (en banc).

84. *Mooney*, 425 F.3d at 1098-99. The court's math was off by 57¢, as the difference between $308,750 and $258,283.03 is actually $50,466.97.

85. *Id.* at 1101.

86. *Id.* at 1099-1100 (quoting U.S.S.G. § 2B1.4, comment. (backg'd.)

87. *See id.* at 1100.

88. *Id.* at 1101.

89. *Olis*, 2005 WL 2842077, at *5.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.* at *7.

94. *MacDonald*, 699 F.2d at 54 (quoting SEC v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978)).

95. *Mooney*, 425 F.3d at 1098.

96. *Id.* at 1101.

97. *See, e.g.,* Mayle v. Felix, 125 S. Ct. 2562, 2569-72 (2005); Chiarella v. United States, 445 U.S. 222 (1980); *Grabske*, 260 F. Supp. 2d at 870 (citing In re Office Solutions, Inc. Sec. Litig., 131 F. Supp. 2d 680, 691 (E.D. Pa. 2001).

98. *Mooney*, 425 F.3d at 1101.

99. *Olis*, 2005 WL 2842077, at *6.

100. U.S.S.G. § 2B1.4, comment. (backg'd.)

101. *Mooney*, 425 F.3d at 1105 n.9 (Bright, J., dissenting) (emphasis added).

102. 15 U.S.C. § 78j(b) (emphasis added); *see also* 17 C.F.R. § 240.10b-5.

103. *Mooney*, 425 F.3d at 1106 (Bright, J., dissenting).

104. *Id.*

105. *Id.* at 1108 n.12 (Bright, J., dissenting); *see also id.* ("I know that sentences under the guidelines have often been subject to harsh criticism as unfair and sometimes irrational and unrealistic, but until today I did not realize that sentences can rest on the gamble of the stock market as in this case … ").

106. *Olis*, 2005 WL 2842077, at *6.

107. *Booker*, 125 S. Ct. at 761.

108. *Id.*

109. *Mooney*, 425 F.3d at 1006-07 (Bright, J., dissenting).

110. *Id.* at 1107 (Bright, J., dissenting).

111. *Id.*

112. Olis, 2005 WL 2842077, at *6.

113. *Id.* at *5 (quoting *W. Coast Aluminum,* 265 F.3d at 991.

114. *Id.* at *6.

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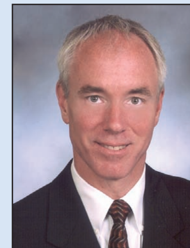

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