

Measuring Insider Trading Damages **By Sheila May, CPA**

Unlike other economic crimes that are measured by the victims' losses, the "gain" quantifies the damages caused by the defendant in insider trading cases.

Sentences are based on the amount of gain. Federal Sentencing guidelines state, "Insider trading is treated essentially as a sophisticated fraud. Because 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."

However, courts are still determining what constitutes gain. Since the amount could be the difference between a life sentence and only a few months in prison, defendants contest the Government's findings and the prosecution will strongly argue that their figure is justified. As a result, courts have struggled to define a competent method to calculate gain.

Two circuit courts have adopted methods for calculating gain in insider trading cases. Before 2009, the Eighth Circuit Court determined gain by calculating the net profit made by the defendant on the purchase and subsequent sale of the stocks in question. This court translated Federal Sentencing Guidelines literally.

The gain is the "total gain" of the defendant whether the gain was due the insider knowledge or normal market forces. This method is relatively easy to calculate. However, it brings up questions in situations where the defendant has engaged in insider trading, but actually incurred a loss.

In July 2009, the Tenth Circuit Court created a split among the circuits when the court ordered the sentence of an insider trading defendant and ordered the district court to calculate "gain" using a method that would instead include

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gains of the defendant up to the point in time when the market was aware of the inside information. This method is called the market absorption method. The Tenth Circuit relied on common law practices of disgorgement in their reasoning. The method is problematic since the time of market absorption can be argued as well as other issues in identifying what part of the gain is attributable to the insider knowledge.

The lack of clarity in determining what constitutes gains is noteworthy for its own reasons and for the implications it has on sentence length. In the market absorption approach, experts must strive to parse out what gains are the result of insider knowledge versus market forces. In the total gain approach, the calculations are easier, but beg the question of what happens if the insider trading resulted in a loss to the defendant. While unclear now, it seems likely that experts on sentencing guidelines, representatives of the market, and the courts will determine a uniform methodology.