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What Does Cooperation Buy You?

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Article

Law360, New York (April 04, 2013, 1:10 PM ET) -- Cooperation. The word is filled with meaning for enforcement professionals. The U.S. Securities and Exchange Commission and the U.S. Department of Justice profess to weigh it heavily when making charging and sanctioning decisions. Courts claim to balance it carefully when making sentencing decisions. But does cooperating really yield tangible benefits for insider trading defendants? Or does it make sense to "roll the dice" and go to trial? Unsurprisingly, the answer is highly fact-specific. But, our analysis of insider trading cases in 2012 and earlier years provides interesting information that may inform the calculus.

What Does It Mean to Cooperate?

This is an important gatekeeper question. Despite detailed frameworks for evaluating cooperation, the SEC and DOJ have provided precious few specifics for insider trading defendants. The SEC engages in a four-part analysis to gauge an individual's cooperation, but at the time of an investigation a potential defendant can control only a single prong: the assistance provided.[1] Here, the SEC factors in both the value and the nature of the cooperation, considering issues like the timeliness and voluntariness of the cooperation and the benefits to the SEC of the cooperation. The DOJ likewise may weigh an individual's cooperation when making charging and sentencing recommendations.[2] The guidelines, akin to the SEC's policies, also focus on the timeliness and comprehensiveness of the defendant's assistance.[3]

Timely cooperation is difficult to provide in an insider trading matter. Investigations frequently begin mere days (if not hours) after the suspicious trading, often without potential defendants being any the wiser. Absent advance self-reporting of insider trading, timeliness thus may best be gauged from the moment of first contact by the authorities.

One case filed in September 2012 demonstrates this redefined timeliness. In that matter, the SEC credited Kenneth F. Wrangell with "promptly offer[ing] significant cooperation."[4] When contacted about his trading in October and November 2010 (the SEC does not identify when the contact occurred), Wrangell "provided truthful details acknowledging his own trading and entered into a cooperation agreement that resulted in direct evidence being quickly developed against" two other defendants. The other defendants consisted of a company insider who told his friend and business associate about an impending merger of the company, who then told his golfing partner Wrangell. But this sort of complete capitulation "at the outset of the investigation" seems to be an anomaly.

Most defendants, therefore, likely may find that their cooperation is most significantly gauged by the value and comprehensiveness of the assistance that they provide. No cooperator to date appears to rival David Slaine in this area. Slaine, who first began cooperating with the FBI in mid-2007, wired up and recorded several of his own conversations with Craig Drimal, which themselves uncovered the Zvi Goffer insider trading network. Slaine's taped conversations with Drimal and involving Goffer were the basis for the Rajaratnam wiretap warrant application. Slaine therefore was credited with securing wiretapped conversations of Rajaratnam. Slaine also received credit for bringing

in additional cooperators, including Gautham Shankar and Thomas Hardin.[5] In support of Slaine's bid for a lenient sentence in early 2012, Assistant U.S. Attorneys Andrew Fish and Reed Brodsky called this cooperation "nothing short of extraordinary."[6]

Entities can cooperate as well. Diamondback Capital Management, for example, settled with both the SEC and DOJ one week after charges were announced.[7] Diamondback secured a nonprosecution agreement with the DOJ based on, among other things, its "prompt and voluntary cooperation upon becoming aware of the government's investigation," its voluntary implementation of remedial measures, and provision of a "detailed Statement of Facts to the U.S. Attorney's Office setting forth the wrongful conduct of two of its employees." As part of its settlements, Diamondback also agreed to disgorge $6 million, and paid a penalty of one-half that amount.

The SEC praised the firm's substantial assistance, "including conducting extensive interviews of staff, reviewing voluminous communications, analyzing complex trading patterns to determine suspicious trading activity, and presenting the results of its internal investigation to federal investigators." Notably, however, Diamondback's pact with the SEC does not include typical language indicating that the firm "neither admits nor denies" any wrongdoing — a result of the SEC's change in policy when settling with defendants involved in parallel criminal matters. And yet, cooperation was not sufficient to save Diamondback from having to shut its doors last year.

What Do Defendants Get From Cooperating?

The possible benefits for early or significantly helpful cooperation are twofold: a reduced (or no) prison sentence and/or a reduced fine/penalty.

Prison (Or Supervised Release) Happens

In many instances, cooperating may provide a "get out of jail" card. For his extraordinary cooperation, for example, Slaine was sentenced in 2012 to probation and no prison time. More broadly, a review of sentences over the last three years reveals that cooperators routinely receive supervised release rather than prison. Of the 20 cooperators sentenced in the last three years, 16 of them received no prison time, and only two cooperators received prison time of more than two years.

On average, cooperating insider trading defendants received a sentence of around six months — only 26 percent of the average prison term imposed after plea bargains from noncooperating defendants (22 months) and a mere 11 percent of the sentences imposed on defendants who went to trial (56 months). Moreover, cooperators received lower sentences than others who entered pleas even though they faced notably higher sentencing guidelines.

In fact, noncooperating plea bargaining defendants met with the longest sentences relative to their sentencing guidelines. Specifically, cooperators received an average sentence equal to only approximately 12 percent of the minimum recommended by the guidelines. In contrast, noncooperating plea bargaining defendants received sentences equal to 73 percent of the minimum guideline, and defendants who went to trial received average sentences equal to 62 percent of the minimum guidelines.

While there were several large insider trading cases and high-profile defendants over the past three years, they do not skew the averages or conclusions to be drawn. This chart illustrates the extent to which each insider trading sentence from 2010 to 2012 deviated from the average sentence (which was half the minimum guideline).[8] We clearly see for cooperators the consistently below-average sentences typically involving no prison time. Also, noncooperators achieve mixed results. The range of outcomes is much wider, for better and worse, among those who enter pleas than it is among those who go to trial.

Further analysis reveals that venue matters when choosing whether to cooperate. In the Southern District of New York, where for decades the majority of criminal insider trading cases have been brought, cooperators received lower overall sentences, and in many cases no prison time. Interestingly, cooperators outside of the Southern District of New York fared less well than noncooperating defendants. And noncooperators fared relatively equally both within and without the Southern District of New York.

Cooperators also received reduced overall sentences regardless of their role in the cases (tipper, tippee, or both). Interestingly, cooperating defendants who both tipped and traded fared best comparatively, perhaps due to the

valuable insight that they could provide to the DOJ. Sentences of noncooperators appear to reflect the more general viewpoint about insider trading: Tipping might not be good, but trading is worse, and doing both is worse still.

Penalties/Fines Happen, Or Do They?

Cooperation may also yield a financial benefit for defendants, albeit perhaps not as significant as compared to the benefits received in sentencing. While cooperators are still required to disgorge any ill-gotten gains, many avoid civil penalties. For example, in the expert network case SEC v. Longoria commenced in 2011, numerous defendants pled guilty in their criminal cases and paid disgorgement in their SEC cases, but none paid a civil penalty, expressly due to their cooperation.[9]

Even where penalties are not avoided entirely, they are likely to be reduced. Stressing that Wrangell's immediate cooperation "saved the SEC time and resources," the SEC nonetheless required disgorgement of his ill-gotten gains ($42,521.55) plus prejudgment interest, and a civil penalty of approximately $11,000, roughly a quarter of what he otherwise would have likely owed had he paid the standard "one time" penalty equal to his alleged trading profits.[10] The relatively small amount of the reduction in penalty begs the question of whether Wrangell received much of a benefit from cooperating with the SEC.

Moreover, while avoiding or reducing penalties, none of these cooperators was able to save themselves from a fraud injunction and significant negative publicity. It is thus not always clear that the reduced civil penalty itself will be worth the costs of cooperating.

A more comprehensive view of the data from 2012 tells a similar story. The SEC commonly seeks a civil penalty equal to disgorgement. Because many defendants receive reduced penalties, however, the average penalty for 2012 was approximately 66 percent of the disgorged amount. [11] Cooperators routinely pay substantially lower, or no, added penalty.

Venue did not significantly affect the civil penalty benefits received by cooperators in 2012. Defendants cooperating with the SEC fared equally well, both within and without the Southern District of New York. Nor did a cooperating defendant's role in the case (tipper, tippee or both) generally result in a difference.

Cooperators likewise, on average, received lower criminal fines. Defendants cooperating with DOJ received an average criminal fine of $38,375 from 2010 to 2012, whereas noncooperating defendants received an average fine of $212,773, more than five times the size of the average fine for a cooperator.

Still a Difficult Path

Cooperation is not all upside. A civil injunction seems a given, an order of disgorgement equal to the ill-gotten gains is an absolute, a felony conviction has many adverse consequences, and reputational damage may be hard to erase. Individuals may have to find themselves a new line of work, since they may also be barred by the SEC from working in the securities business. Likewise, it seems almost routine now to ask cooperators to record conversations with their friends and colleagues. And cooperators should expect that they may be deposed in civil suits and provide trial testimony in civil and criminal cases.

Even cooperating businesses may suffer debilitating reputational and business harms from insider trading cases involving their employees. Despite its significant cooperation, as stated above, Diamondback informed investors in December 2012 that it would close in light of significant redemption requests. At least three other firms (Level Global Investors, Barai Capital Management and Loch Capital Management) likewise shut down after their employees were implicated in insider trading cases.

Cooperation: Summing Up

Based on cases in the past three years, cooperation with the U.S. Attorney's Office for the Southern District of New York still yields significant benefit. Cooperators on average received lower overall sentences than noncooperators — both those who pled without cooperation and those who went to trial. As has been true for decades, cooperators were far more likely than noncooperators in insider trading cases to get a sentence that included no prison time at all.[12] The benefits of cooperating outside of New York are less clear as noncooperating defendants appear to have

received similar (if not slightly lower) sentences than cooperators.

Whether to cooperate outside of the Southern District of New York may come down to an evaluation of the costs of cooperation (are they seeking Slaine-type active cooperation, or something more manageable?) and the track record of the local U.S. Attorney's Office in delivering on the cooperation agreement's promise to bring the "nature and extent" of the cooperation to the attention of the sentencing judge. There appears to be little question that cooperating with the SEC will result in a reduced civil penalty. Yet the civil penalties imposed through default or summary judgment are generally not dauntingly high, and the SEC's success rate litigating is nowhere near the United States Attorney's Office for the Southern District of New York's recent unbeaten streak.

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[1] See SEC Enforcement Manual at § 6.1.1 (Nov. 1, 2012), 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 personal and professional profile of the individual (including the individual's history of lawfulness, degree of acceptance of responsibility, and opportunity to commit future violations).

[2] See United States Attorney's Manual at 9-27.230,9-27.740, available at http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/27mcrm.htm#9-27.600.

[3] See United States Sentencing Guidelines Manual at § 5K1.1, United States Sentencing Commission (Nov. 1, 2012), available at http://www.ussc.gov/Guidelines/2012_Guidelines/Manual_HTML/5k1_1.htm.

[4] See Press Release, SEC, SEC Charges Three in North Carolina With Insider Trading (Sept. 20, 2012), available at http://www.sec.gov/news/press/2012/2012-193.htm.

[5] See Government's Sentencing Memorandum at 6, United States v. Slaine, No. 09-cr-01222 (RJS) (S.D.N.Y. Jan. 9, 2012), ECF No. 13.

[6] Id. at 4.

[7] Press Release, U.S. Att'y's Off., S.D.N.Y., Manhattan U.S. Attorney Announces Agreement with Diamondback Capital Management, LLC to Pay $6 Million to Resolve Insider Trading Investigation (Jan. 23, 2012), available at http://www.justice.gov/usao/nys/pressreleases/January12/diamondbacknpa.html; Press Release, SEC, Diamondback Capital Agrees to Settle SEC Insider Trading Charges (Jan. 23, 2012), available at http://www.sec.gov/news/press/2012/2012-16.htm.

[8] One non-cooperating plea was excluded from this chart because the six-month prison term could not be expressed as a percentage of the minimum guideline of 0 months.

[9] See SEC v. Longoria, et al., No. 11-cv-00753 (JSR) (S.D.N.Y.).

[10] See Press Release, SEC, SEC Charges Three in North Carolina With Insider Trading (Sept. 20, 2012), available

at http://www.sec.gov/news/press/2012/2012-193.htm. Notably, the tipper's settlement assessed a one-time penalty equal to the trading profits of his first-level tippee (over $40,000). And the first-level tippee agreed in his settlement to pay the amount of penalty set by the court.

[11] The chart and average SEC penalties referenced herein exclude proceedings involving disgorgement of less than $25,000 and proceedings in which the SEC noted either that a penalty was yet to be determined or that no penalty was imposed as a result of the defendant's financial condition or a parallel criminal proceeding.

[12] Carl H. Loewenson, Jr., Plea Bargaining in Securities Cases, 14 Rev. Sec. Comm. Reg. 145 (Aug. 1991).