HALTING THE SENSELESS CIVIL WAR AGAINST WHITE-COLLAR OFFENDERS: “THE CONDUCT UNDERMINED THE INTEGRITY OF THE MARKETS” AND OTHER FALLACIES

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ABSTRACT

White-collar offenders understandably attract a significant amount of resentment and animosity. They often make large profits through cheating the financial system. The antipathy the community feels towards these offenders has resulted in increasingly tough sanctions being meted out to them. In the United States, it is not uncommon for white-collar offenders to be sentenced to imprisonment for over a decade. This approach is fundamentally flawed. It is an illustration of collective community venting prevailing over sound evidence-based policy. This Article focuses on white-collar offenders who cheat the stock market. We argue that the reflexive unabated practice of increasingly harsh penalties for offenders who commit insider trading and market manipulation offenses has resulted in the community punishing itself by directing scarce public resources into the prison industry and away from demonstrable social goods in the form of education and health, without any corresponding benefit to the community. The two main reasons for imposing harsh sentences on market cheats are the desire to deter others from committing similar offenses and to maintain the integrity of the markets. In this Article, we demonstrate that these rationales are flawed. The weight of existing empirical data establishes that long prison terms do not deter people from committing similar offenses. We also examine the impact of high profile market offenses on the value of shares. The Article contains

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an empirical analysis regarding whether there is a link between white-collar offenses and the integrity of the markets (which is an assumption made by courts). The study shows that there is no demonstrable link between major stock market crime and a lowering in the value of the market. The value of the stock market does not normally fall in response to high profile financial market offenses. This Article argues that the civil war against white-collar offenders should stop. The humanistic toll on white-collar offenders (as a result of being subjected to disproportionate punishment) and the financial burden on the community stemming from the burgeoning cost of imprisonment have already produced too much self-inflicted harm. Imprisoning fewer white-collar (and other fraud) offenders will assist in ameliorating the incarceration crisis in the United States while at the same time ensuring that proportionate penalties are imposed on such offenders. It will also hopefully provide the impetus for more wide-ranging evidence-based reforms to the sentencing system, which has resulted in more than two million Americans being incarcerated—the highest in history.

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INTRODUCTION

White-collar and other fraud offenders are regularly sentenced to imprisonment, and often for long terms. In fact, the trend is to increase the severity of penalties for these offenders. There is no countermovement to this trend. This is to be expected given that there is little, if any, community empathy for offenders who profit by cheating the market.

Yet, sentencing should be a rational social endeavor. It is the area of law where the community acts in its most coercive manner against private citizens. The deliberate infliction of pain against citizens must have a demonstrated justification beyond the impulse to punish wrongdoers. This Article argues that there is no rational basis for subjecting white-collar offenders to long prison terms. This is especially the case in relation to stock market offenders.

Sentencing is too important for outcomes to be driven by “common sense” and reflexive sentiments regarding what feels right or seems correct. Instead the process should be driven by evidence-based principles, which take into account the objectives that can be achieved through state-imposed punishment and normative ideals regarding the proper aims and justification of punishment.

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The main consideration that should guide penalty type and length is the principle of proportionality, which stipulates that the harshness of the punishment should match the seriousness of the crime. The key reason that white-collar offenses should be dealt with less severely than is currently the practice is because empirical data establishes that these offenses cause far less harm than violent and sexual offenses. In short, the harshest criminal sanctions should generally be reserved for the crimes that cause the most harm. White-collar offenses are not in this offense category. This is especially so in relation to white-collar offenses that do not cause a demonstrable loss to individuals. It is these offenses, in the form of insider trading and market manipulation crime, that are the focus of this Article.

While insider trading and market manipulation offenses often do not have identifiable victims, the harsh sanctions that are typically imposed on such offenders are often sought to be justified on the basis of two key rationales. These objectives are general

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5. This is the theory that a harsh sanction will discourage the particular offender from reoffending. See infra Part III.

6. See infra Part IV.

7. The harshest criminal sanction in the United States is obviously the death penalty. However, in assessing the nature of gravity of criminal sanctions we exclude the death penalty. The United States is the only developed nation apart from Japan that still imposes the death penalty. Death Penalty Statistics Country by Country, GUARDIAN, https://www.theguardian.com/news/datablog/2011/mar/29/death-penalty-countries-world#data [https://perma.cc/2QDN-QNLM] (last visited Oct. 24, 2016). Because of its extreme nature, the death penalty raises for discussion a number of different human rights and normative considerations. Indeed, the literature and analysis regarding the desirability of the death penalty is voluminous. It can only be examined in the context of a stand-alone dissertation focusing on this issue. This is not a meaningful limitation to this paper given that not all states impose the death penalty and since 1976 there have been less than 1,421 executions. Facts About the Death Penalty, DEATH PENALTY INFO. CTR., http://www.deathpenaltyinfo.org/documents/FactSheet.pdf [https://perma.cc/H2AK-T4T7] (last updated Aug. 30, 2016). There are thirty-one states that still have the death penalty. Id.

8. We also focus on insider trading and market manipulation offenses because these offenses often involve very large sums of money and receive media attention. See, e.g., Hristova, supra note 1, at 268-69 (discussing the high-profile case of Ivan Boesky). This enables us to test the hypothesis that there is a supposed link between such crimes and activity in the market.

9. Although they do not have identifiable victims, we accept that this conduct should be a criminal offense. For a counter view, see some of the arguments set out in Hristova, supra note 1. The author ultimately accepts that the better view is that insider trading should be a crime.
deterrence and the desire to maintain the integrity of (and investor confidence in) the stock market. Both these rationales are flawed.

The empirical data shows that, contrary to common sense, harsh sanctions do not deter crime. Further, the link between offenses committed involving the stock market and a reduction in confidence in the integrity of the market has not been validated. In this Article, we test the impact that high profile insider trading and market manipulation cases have on the value of the stock market. We do this by examining the change in the value of the stock market on the day of the relevant sentence, the following day, and a week after the sentence. We conclude that there is no evidence of a link between serious stock market crime and the value of the stock market. Our study shows that in the period shortly after a sentence is handed down for a major stock market offense the value of the market more commonly increases than decreases at about the same rate as general movements in the market.

An empirically grounded application of sentencing principles to white-collar offenses, and in particular to financial market cheats, would result in a considerable reduction in the penalties imposed on offenders. Prison would be used far more sparingly in relation to these offenders and, when it is used, the duration should be considerably shorter than is currently the norm.

If the reform recommendations in this Article are adopted, this would result in a reduction in use of imprisonment and increase the fairness in the sentencing process. Just as importantly, there would be no ensuing disadvantages. The community would be no less safe and confidence in the markets would not diminish.

It is particularly opportune and timely to consider these reforms given the recognition that there are now too many Americans in United States prisons. It costs taxpayers in the United States on

10. Which, as discussed below, is the theory that higher penalties deter crime.

11. See, e.g., Hristova, supra note 1, at 296-99 (discussing the effect of over criminalization in white-collar crime and its deterrent effect).

12. More than 2 million Americans are in federal prisons, state prisons, and local jails. For a breakdown of the incarceration numbers, see Pete Wagner and Bernadette Rabuy, Mass Incarceration: The Whole Pie 2015, PRISON POL’Y INITIATIVE (Dec. 8, 2015), http://www.prisonpolicy.org/reports/pie2015.html [https://perma.cc/2C6Z-TTEE]. This is an imprisonment rate of approximately 700 adults for every 100,000 of the adult population. Melissa S. Kearney et al., Ten Economic Facts About Crime and Incarceration in the United States, HAMILTON PROJECT 9 (May 2014), https://www.brookings.edu/wp-content/uploads/2016/06/v8_THP_10CrimeFacts.pdf [https://perma.cc/7TNS-QQKW]. This rate has increased more than four-fold over the
average $31,000 in direct expenditures to house a prisoner for one year. The total spending on prisons is now over $80 billion annually. The scale of this, even for the world’s largest economy, is considerable, especially when overall the total expenditure on the criminal justice system is $270 billion annually—equating to nearly $1,000 per capita. The climate is now right for a deeper look at serious changes to the sentencing system. This Article progresses that debate.

In this Article, we focus principally on insider trading and market manipulation offenses in the United States. For comparative purposes, we also discuss the sentencing of white-collar offenders in Australia. It emerges that despite the strikingly different sentencing regimes in these countries, both systems make similar mistakes in sentencing financial market offenders. Moreover, an examination of insider trading and market manipulation offenses in Australia enables us to broaden the scope of our empirical analysis and test the past 40 years. Incarceration, SENT’G PROJECT, http://www.sentencingproject.org/template/page.cfm?id=107 [https://perma.cc/KJ6W-CU9S] (last visited Oct. 24, 2016); see also NAT’L RESEARCH COUNCIL, THE GROWTH OF INCARCERATION IN THE UNITED STATES: EXPLORING CAUSES AND CONSEQUENCES 68 (Jeremy Travis, Bruce Western & Steve Redburn eds., 2014). The United States now has the highest incarceration rate in the developed world, and by a considerable margin. See Wagner and Rabuy, supra. The imprisonment rate in most developed countries is five to ten times less than the United States, and on average is six times that of a typical nation in the Organization for Economic Co-Operation and Development (OECD). Rates in the OECD range from 47 to 266 per 100,000 adult population. Kearney et al., supra, at 10; see also Nick Wing, Here Are All of the Nations that Incarcerate More of Their Population than the U.S., HUFFINGTON POST (May 4, 2015), http://www.huffingtonpost.com/2013/08/13/incarceration-rate-per-capita_n_3745291.html [https://perma.cc/4B82-E4E8] (“At 716 per 100,000 people in 2013, according to the International Centre for Prison Studies, the U.S. tops every other nation in the world. Among OECD countries, the competition isn’t even close – Israel comes in second, at 223 per 100,000.”).

13. According to a study by the Vera Justice Center, the average cost of a prisoner is $31,286 per year. This is higher in some states and cities. For example, in New York State the average cost is $60,000 per year and in New York City it is $167,731 per year. See Marc Santora, City’s Annual Cost Per Inmate is $168,000, Study Finds, N.Y. TIMES (Aug. 23, 2013), http://www.nytimes.com/2013/08/24/nyregion/citys-annual-cost-per-inmate-is-nearly-168000-study-says.html?_r=0 [https://perma.cc/C598-RBKY].


connection between sentences for serious market cheating offenses and the value of the stock market.

In the next part of the Article, we define the key terms and concepts discussed in the Article. Part II of the Article explains the existing sentencing approach in the United States and Australia and sets out the most significant penalties that have been imposed for insider trading and market manipulation offenses. This is followed in Part III by an analysis of the key relevant sentencing objectives that can be secured through the sentencing system. In this Part, we also set out the results of our empirical study, which analyzes whether there is a link between market crime and the value of the stock market. In Part IV, we establish that the principle of proportionality should be the cardinal consideration in sentencing. This Part of the Article also contains concrete illustrations of the types of sentences that should be imposed in fraud cases. The reform recommendations are summarized in the concluding remarks.

I. DEFINITIONAL ISSUES

There is no universally accepted definition of white-collar crime, despite the concept first being introduced nearly eighty years ago by Edwin Sutherland as a crime “committed by a person of respectability and high social status in the course of his occupation.” This definition is inadequate because notions such as “respectability” and “social status” are too obscure to be meaningful, and white-collar offending clearly transcends occupational or workplace transgressions.

In a more recent analysis of white-collar crime in his book, Lying, Cheating, and Stealing: A Moral Theory of White-Collar Crime, Stuart Green declines to attempt an exhaustive definition of what is encompassed by the concept. He notes that the conduct often concerns behavior at the margins of the criminal spectrum but that

16. This was the description given by Sutherland in a speech he delivered to the American Sociological Society in 1939. See J. Kelly Strader, Understanding White Collar Crime 1 (3d ed. 2011).


there is no universally accepted definition of “white-collar crime.” He believes that there does not seem to be a single characteristic criterion that all forms of white-collar crime share.19

While there is no consensus on the definition of a white-collar crime, a working definition is important for a coherent analysis of existing jurisprudence. To that end, one of us has previously asserted that a white-collar crime involves an action of taking money or property (such as shares) or avoiding a legal obligation (such as a tax liability) without legal justification by an individual who is in a position of substantial influence regarding the relevant transaction.20

The discussion in this Article focuses on two paradigm instances of white-collar offending, both of which often attract a large degree of public opprobrium and often publicity. The first offense is insider trading. In the United States, section 10(b) of the Securities Exchange Act of 1934 and the associated rule 10b-5 “prohibits individuals from using interstate commerce, the mail, or a national securities exchange to (i) use a device, scheme, or artifice to defraud, (ii) make any untrue or misleading statements of material

19. Stuart P. Green, Lying, Cheating, and Stealing: A Moral Theory of White-Collar Crime 18 (2006). The elusive nature of the definition of white-collar crime is further illustrated by the fact that J. Kelly Strader attempts to demarcate it by what it is not. See Strader, supra note 16, at 2. According to Strader, a white collar crime is one that does not: (a) necessarily involve force against a person or property; (b) directly relate to the possession, sale, or distribution of narcotics; (c) directly relate to organized crime activities; (d) directly relate to such national policies as immigration, civil rights, and national security; or (e) directly involve “vice crimes” or the common theft of property. Id.

20. See Mirko Bagaric & Theo Alexander, A Rational Approach to Sentencing White-Collar Offenders in Australia, 34 Adelaide L. Rev. 317 (2013). This is similar to the partial definition proposed by the United States Department of Justice, which gave a partial definition of white-collar crime in the following terms: Nonviolent crime for financial gain committed by means of deception by persons whose occupational status is entrepreneurial, professional or semi-professional and utilizing their special occupational skills and opportunities; also, nonviolent crime for financial gain utilizing deception and committed by anyone having special technical and professional knowledge of business and government, irrespective of the person’s occupation.

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A narrower definition is adopted in Australia. The Corporations Act 2001 (Cth) states that a person who possesses inside information is prohibited from (either as agent or principal) acquiring or disposing the relevant financial product, enter into agreements to that effect, or procure another to enter into such agreements. The persons in possession of price-sensitive information are also prohibited from giving the information to another if they know or reasonably ought to know that the person receiving the knowledge would likely engage in the conduct listed above.

Market manipulation is defined and applied similarly in both jurisdictions. In the United States, a person is prohibited from willingly creating misleading appearances of active trading in securities listed on a stock exchange. In Australia, it is defined as a prohibition from taking part in or carrying out (directly or indirectly) a transaction that has or is likely to create or maintain an artificial price of the relevant financial product.

The key aspect of insider trading and market manipulation offenses is that while often the offender makes a financial gain or avoids a loss, generally there is no discernible concrete loss to any particular shareholder or other individual. In circumstances where it is feasible to approximate a loss to a particular shareholder, the loss is generally quite small. In this way, insider trading offenses and market manipulation are distinguishable from most other white-collar offenses. Most other white-collar offenses involve

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22. Information which is not generally available, and if it were, a reasonable person would expect it to have a particular effect on the price of the particular financial product in question. Corporations Act 2001 (Cth) § 1042A.
23. Id. § 1043A(1).
27. As Peter Henning suggests in a New York Times article, “Insider trading is different from corporate accounting fraud because it does not have the same effect on individual investors. . . . [Insider trading] has little direct consequence for investors because the transactions take place on anonymous markets.” Peter J. Henning, Punishments for Insider Trading are Growing Stiffer, N.Y. TIMES (Sept. 9, 2014, 10:44 AM), http://dealbook.nytimes.com/2014/09/09/
identifiable victims and losses that are clearly ascertainable; for example, where a lawyer or accountant steals trust funds belonging to clients.

In the case of insider trading, the persons who sell their shares to persons with inside information are prepared to sell the shares at that particular price or buy the shares at a particular price without having knowledge about information that might affect the price. In both situations, the loss for the victims is reflected in the adjustment that would occur, either upwards or downwards, when the price-sensitive information becomes known. 28 The same considerations apply to market manipulation. Even though those who trade would not know that the market has been manipulated, they are prepared to trade. In other words, they make decisions based on their own desire either to buy or sell securities—it is a rational subjective decision they make. Those who manipulated the market obviously get an unfair advantage, but there may be many other investors, not knowing that the market was manipulated, who would sell their securities and therefore avoid receiving a lower price for their securities when the security price is adjusted downwards when it becomes known that there was market manipulation. It is true that those buying the shares would be affected by the lower security price, but they were not “harmed” by those who sold their securities without knowledge that the market was manipulated.

Thus, it is not contended that insider trading and market manipulation offenses are victimless from the perspective of the

punishments-for-insider-trading-are-growing-stiffer/?_r=0 [https://perma.cc/X6EV-NFT9]. It is largely for this reason that some scholars that suggested that insider trading should not be a crime. For example, see the arguments set out in Hristova, supra note 1.

individual. Rather, as opposed to other white-collar offenses, they often involve no identifiable victims and when they do, the losses are generally not considerable—they are a portion of a share price as opposed to, say, an individual’s life savings.

II. THE EXISTING SENTENCING FRAMEWORK

Before examining the legal framework for insider trading and market manipulation offenses, it is useful to provide an overview of the overarching sentencing regimes in the United States and Australia.

A. Sentencing Law in the United States: An Overview

Each state in the United States and the federal jurisdiction has its own separate sentencing system. While each system is different, there are important commonalities. The main objectives of sentencing are similar and come in the form of community protection (also known as incapacitation), general deterrence, specific deterrence, rehabilitation, and retribution. While these aims are relatively uniform, they are not equal in weight. Community protection has been the overwhelming aim of sentencing in the United States over the past forty years.

The goal of community protection has been most demonstrably pursued through the enactment of prescriptive sentencing laws.


32. Id. at 3. As noted by William W. Berry III, Prior to 1984, federal judges possessed discretion that was virtually “unfettered” in determining sentences, guided only by broad sentence ranges provided by federal criminal statutes. The Sentencing Reform Act of 1984 (the “Act”) moved the sentencing regime almost completely to the other extreme, implementing a system of mandatory guidelines that severely limited the discretion of the sentencing judge.
Fixed, minimum, or presumptive penalties now apply (to varying degrees) in jurisdictions in the United States. Prescribed penalties are typically set out in sentencing grids, which normally use criminal history scores and offense seriousness to calculate the appropriate penalty. The penalties prescribed in the grids have been heavily criticized for being too harsh. Typical of this sentiment is the following observation by Michael Tonry:

Anyone who works in or has observed the American criminal justice system over time can repeat the litany of tough-on-crime sentencing laws enacted in the 1980s and the first half of the 1990s: mandatory minimum sentence laws (all 50 states), three-strikes laws (26 states), [life-without-possibility-of-parole] laws (49 states), and truth-in-sentencing laws (28 states), in some places augmented by equally severe “career criminal,” “dangerous offender,” and “sexual predator” laws (Tonry, 2013). These laws, because they required sentences of historically unprecedented lengths for broad categories of offenses and offenders, are the primary causes of contemporary levels of imprisonment.

The most extensively analyzed prescribed penalty laws are in the United States Sentencing Commission Guidelines Manual (the “Federal Sentencing Guidelines”). Guidelines are important because of the large number of offenders sentenced under this system and the significant doctrinal influence they have exerted at


33. For the purposes of clarity, these both come under the terminology of fixed or standard penalties in this Article.

34. They are also one of the key distinguishing aspects of the United States’s sentencing system compared to that of Australia (and most other sentencing systems in the world). See CONNIE DE LA VEGA ET AL., CRUEL AND UNUSUAL: U.S. SENTENCING PRACTICES IN A GLOBAL CONTEXT 46-47 (2012) (noting that 137 of 168 surveyed countries had some form of minimum penalties, but none of the others were as wide-ranging or severe as in the United States).

35. This is based mainly on the number, seriousness, and age of the prior convictions.


the state level.\textsuperscript{39} Like most grid sentencing systems, the key considerations that determine the nature of the penalty are the perceived severity of the offense and the criminal history of the offender.\textsuperscript{40} Prior convictions can have a considerable impact on penalty, and in some cases lead to an approximate doubling of the sentence. For example, an offense at level 15 in the Federal Sentencing Guidelines carries a presumptive penalty for a first offender of imprisonment for 18-24 months,\textsuperscript{41} which increases to 41-51 months for an offender with 13 or more criminal history points.\textsuperscript{42} For an offense at level 35, a first offender has a guideline penalty range of 168-210 months, which increases to 292-365 months for an offender with the highest criminal history score.\textsuperscript{43} Thus, an extensive bad criminal history can add 155 months (more than 12 years) to a jail term.

Following the U.S. Supreme Court decision of \textit{United States v. Booker},\textsuperscript{44} the Federal Sentencing Guidelines are no longer

\textsuperscript{39} See Berman & Bibas, \textit{supra} note 37, at 38. There are more than 200,000 federal prisoners. \textit{See E. Ann Carson, Prisoners in 2013}, \textit{BUREAU JUST. STAT.} 2 (Sept. 30, 2014), \url{http://www.bjs.gov/content/pub/pdf/p13.pdf} [https://perma.cc/9UXM-DHZP].


\textsuperscript{41} \textit{U.S. SENTENCING COMM’N 2014, supra} note 30, at 400. The offense levels range from 1 (least serious) to 43 (most serious). \textit{Id.}

\textsuperscript{42} \textit{Id.} The criminal history score ranges from 0 to 13 or more (worst offending record). \textit{Id.}

\textsuperscript{43} \textit{Id.}

\textsuperscript{44} \textit{United States v. Booker}, 543 U.S. 220 (2005). In \textit{Booker}, the Supreme Court held that aspects of the Guidelines that were mandatory were contrary to the Sixth Amendment right to a jury trial. \textit{Id.} at 258-59 (Breyer, J., concurring); \textit{see also} Pepper v. United States, 131 S. Ct. 1229, 1236 (2011) (“[W]hen a defendant’s sentence has been set aside on appeal, a district court at resentencing may consider evidence [that may] support a downward variance from the now-advisory Federal Sentencing Guidelines range.”); Irizarry v. United States, 553 U.S. 708, 715 (2008) (“[T]here is no longer a limit comparable to the one at issue in \textit{Burns} on the variances from Guidelines ranges that a district court may find justified under the sentencing factors set forth in 18 U.S.C. § 3553(a).”); Greenlaw v. United States, 554 U.S. 237 (2008); Gall v. United States, 552 U.S. 38, 38-39 (2007) (“[W]hile the extent of the difference between a particular sentence and the recommended Guidelines range is relevant, courts of appeals must review all sentences—whether inside, just outside, or significantly outside the Guidelines range—under a deferential abuse-of-discretion standard.”); Rita v. United States, 551 U.S. 338, 350 (2007) (stating that a federal appellate court may apply presumption of reasonableness to a district court sentence that is within the properly calculated Sentencing Guidelines range).
mandatory; rather they are effectively advisory in character.\textsuperscript{45} Nevertheless, the guideline range remains an influential sentencing reference point. Until recently, sentences within the Guidelines were still the norm.\textsuperscript{46} In 2014, for the first time, federal courts imposed more sentences that were outside the Federal Sentencing Guidelines than sentences that were within them. The margin is small (54\% to 46\%), but it does reflect a trend by the judiciary to view the Federal Sentencing Guidelines with less stricture than previously.\textsuperscript{47}

While criminal history score and offense severity are the main sentencing considerations, they do not exhaust all of the matters that influence the penalty. Courts can depart from a guideline for a number of reasons. The Guidelines expressly set out over three dozen considerations that can affect the penalty.\textsuperscript{48} To determine the

\begin{itemize}
\item 45. Consequently, District Courts are required to properly calculate and consider the Guidelines when sentencing, even in an advisory guideline system. See 18 U.S.C. § 3553(a)(4)-(5) (2010); Booker, 543 U.S. at 264 (“The district courts, while not bound to apply the Guidelines, must . . . take them into account when sentencing.”); Rita, 551 U.S. at 351 (stating that a district court should begin all sentencing proceedings by correctly calculating the applicable Guidelines range); Gall, 552 U.S. at 49 (“As a matter of administration and to secure nationwide consistency, the Guidelines should be the starting point and the initial benchmark.”). The district court, in determining the appropriate sentence in a particular case, therefore, must consider the properly calculated guideline range, the grounds for departure provided in the policy statements, and then the factors under 18 U.S.C. § 3553(a). See Rita, 551 U.S. at 350-51; see also Gall, 552 U.S. at 38 (“A district judge must consider the extent of any departure from the Guidelines and must explain the appropriateness of an unusually lenient or harsh sentence with sufficient justifications. An appellate court may take the degree of variance into account and consider the extent of a deviation from the Guidelines, but it may not require ‘extraordinary’ circumstances or employ a rigid mathematical formula using a departure’s percentage as the standard for determining the strength of the justification required for a specific sentence.”).
\item 48. See U.S. SENTENCING COMM’N 2014, supra note 30, at 457.
\end{itemize}
appropriate guideline penalty, courts may factor in a number of mitigating and aggravating considerations.\textsuperscript{49} They come in two main forms: adjustments and departures.

“Adjustments” are considerations that increase or decrease penalty by a designated amount.\textsuperscript{50} For example, a demonstration of remorse can result in a decrease of penalty by up to two levels; it can decrease three levels if it is accompanied by an early guilty plea.\textsuperscript{51} “Departures”\textsuperscript{52} more readily enable courts to impose a sentence outside the applicable Guideline range.\textsuperscript{53} Further, pursuant to 18 U.S.C. § 3553, in rare instances considerations that are not set out in the Guidelines can be invoked to justify departing from the range.\textsuperscript{54} Where a court departs from the applicable range, it is required to state its reason.\textsuperscript{55}

B. Sentencing Law in the United States: Insider Trading

So far as white-collar offenders are concerned, they are subject to the general sentencing principles. However, there are also some sentencing principles that apply more acutely to white-collar crime offenders. White-collar crime sentences are similar to other federal drug crimes in terms of sentencing, but rather than using quantity to determine a sentence, sentencing for white-collar crime has as a key focus the amount of economic loss caused by the crime.

In recent decades in the United States, an attitude developed that white-collar crime defendants were given an unreasonable degree of leniency in sentences, and that the punishment did not fit

\textsuperscript{49}. See id. at 6; 18 USC § 3553(b)(1).
\textsuperscript{50}. These are set out in Chapter 3 of the U.S. Sentencing Guidelines. U.S. SENTENCING COMM’N 2014, supra note 30, at 341.
\textsuperscript{51}. Id. at 371. However, § 5K2.0(d)(4) of the 2014 Guidelines provides that the court cannot depart from a guideline range as a result of:

- The defendant’s decision, in and of itself, to plead guilty to the offense or to enter a plea agreement with respect to the offense (i.e., a departure may not be based merely on the fact that the defendant decided to plead guilty or to enter into a plea agreement, but a departure may be based on justifiable, non-prohibited reasons as part of a sentence that is recommended, or agreed to, in the plea agreement and accepted by the court.

\textit{Id.} at 460 (citation omitted).
\textsuperscript{52}. Id. at 457.
\textsuperscript{53}. Id.
\textsuperscript{54}. Id. at 458; see also Gall v. United States, 552 U.S. 38, 47 (2007); Pepper v. United States, 131 S. Ct. 1229, 1247 (2011).
\textsuperscript{55}. U.S. SENTENCING COMM’N 2014, supra note 30, at 461.
the crime. There was an enormous amount of political pressure to amend the sentencing guidelines for white-collar crime, and as a result, the Sarbanes–Oxley Act went into effect. Following the enactment of the Sarbanes–Oxley Act, penalties for white-collar crimes increased by twenty-five percent, with the amount of “loss” being the overarching factor in determining a sentence.

More recently, in April 2015, there were proposed amendments for the sentencing guidelines dealing with white-collar crime. The proposed changes to the Federal Sentencing Guidelines came into effect on November 1, 2015. These changes not only encompassed a number of major revisions to the law, including new definitions in the commentary, but also made the recommended sentences so severe that it has been suggested by some prosecutors and judges that they may no longer be taken seriously. The changes, as summarized below, focus mainly on the defendant’s intent and motive, as well as the amount of loss as a result of the offense.

Section 2B1.1 of the Federal Sentencing Guidelines provides the framework for the sentencing of white-collar criminals. There are three main considerations that are relevant to the sentencing of

57. Id.
58. Id.
such offenders: (1) economic loss; (2) culpability; and (3) victim impact.\footnote{A Report on Behalf of the American Bar Association Criminal Justice Section Task Force on the Reform of Federal Sentencing for Economic Crimes, AM. BAR ASS’N: CRIM. JUST. SEC. 1, 5 (Nov. 10, 2014), http://www.americanbar.org/content/dam/aba/uncategorized/criminal_justice/economic_crimes.authcheckdam.pdf [https://perma.cc/ZVW4-WDUG].} We now consider each of these in greater detail.

Most important of these three main considerations is loss. Under the Guidelines, the base offense level for white-collar crimes is 6-8.\footnote{U.S. SENTENCING COMM’N 2015, supra note 59, § 2B1.1(a).} The Guidelines provide a “loss” table to determine how many levels to add to the offense based on the amount of economic “loss” attributable to the defendant’s crime.\footnote{Id. § 2B1.1(b)(1).} Loss is not simply defined as the amount of money lost during the commission of the crime, but rather, the Guidelines define what constitutes a “loss” as it relates to white-collar crime. “Loss” is the greater of actual loss or intended loss.\footnote{Id. application note 3(A).}

“‘Actual loss’ means the reasonably foreseeable pecuniary harm that resulted from the offense.”\footnote{Id. application note 3(A)(i).} “Intended loss (I) means the pecuniary harm that the defendant purposely sought to inflict; and (II) includes intended pecuniary harm that would have been impossible or unlikely to occur (e.g., as in a government sting operation or an insurance fraud in which the claim exceeded the insured value).”\footnote{Id. application note 3(A)(ii).} The Guidelines then determine the sentencing range based on a combination of the offense level and the offender’s criminal history.\footnote{Id.; U.S SENTENCING COMM’N, SENTENCING TABLE (2015) [hereinafter GUIDELINES SENTENCING TABLE 2015], http://www.uscc.gov/sites/default/files/pdf/guidelines-manual/2015/Sentencing_Table.pdf [https://perma.cc/AL9U-78VQ].}

As the Guidelines suggest, the greater the loss as a result of the crime, the more likely a judge will apply an increase in the sentencing adjustment. For example, if the loss exceeded $6,500, the offense level can increase anywhere from 2 levels up to 30 levels.\footnote{U.S. SENTENCING COMM’N 2015, supra note 59, § 2B1.1.} Thus, if the loss incurred was $6,500 or less, and the offender has no criminal history, the offender may face up to six months imprisonment.\footnote{GUIDELINES SENTENCING TABLE 2015, supra note 69.} However, at the other end of the spectrum, if the loss involved more than $550,000,000, then 30 points would be
added to the offense level.\textsuperscript{72} This means that an offender with no criminal history, at minimum, could face 97-121 months imprisonment.\textsuperscript{73} This increase in levels is determined even before any other aggravating or mitigating factors are taken into consideration at sentencing.

Further sentencing points may be added to the offense level based on the offender’s level of culpability. The Guidelines have five levels of culpability that range from lowest to highest.\textsuperscript{74} The level of culpability for any given case will depend on a number of factors, including, but not limited to, the defendant’s motive; the correlation between the amount of loss and the amount of the defendant’s gain; the degree to which the offense and the defendant’s contribution to it was sophisticated or organized; the duration of the offense; extenuating circumstances in connection with the offense; whether the defendant initiated the offense or merely joined in criminal conduct initiated by others; and whether the defendant took steps to mitigate the harm from the offense.\textsuperscript{75} Unlike for the amount of loss, the Guidelines do not assign a numeric score to each of the culpability factors listed above. Rather, the court determines one of the five culpability levels after taking the culpability factors together in totality.\textsuperscript{76}

One factor that is highly relevant to the defendant’s culpability level is the defendant’s motive. The American Bar Association has recognized four main motives. From most to least serious they are as follows: predatory, legitimate ab initio, risk shifting, and gatekeeping.\textsuperscript{77} Predatory offenses are intended to inflict loss for the sole purpose of personal gain to the defendant.\textsuperscript{78} Legitimate ab initio offenses typically “arise from otherwise legitimate efforts that have crossed over into criminality as a result of unexpected difficulties,” and these rank lower than predatory offenses.\textsuperscript{79} Below legitimate ab initio offenses are risk-shifting offenses, which shift any potential risk of loss from the defendant to a third party, such as the victim of

\textsuperscript{72} U.S. SENTENCING COMM’N 2015, supra note 59, § 2B1.1.
\textsuperscript{73} GUIDELINES SENTENCING TABLE 2015, supra note 69.
\textsuperscript{74} AM. BAR ASS’N, supra note 63, at 1.
\textsuperscript{75} Id.
\textsuperscript{76} Id.
\textsuperscript{77} Id. at 2-3.
\textsuperscript{78} Id. at 2.
\textsuperscript{79} Id. at 3.
the crime.\textsuperscript{80} Lastly, gatekeeping offenses are not intended to cause loss, but, rather, “they violate so-called ‘gatekeeping’ requirements intended generally to prevent practices that create potential loss or [actual] risk of loss.”\textsuperscript{81} It is possible for an offense to fit into more than one of the four categories. The court should also consider how the defendant’s motive compares to that of other defendants sentenced under this section of the Guidelines.\textsuperscript{82}

The next consideration that informs culpability is the amount of gain and whether it correlates with the amount of loss. Where the defendant commits the offense and gains an amount that is commensurate with the loss, this will result in a higher degree of culpability.\textsuperscript{83} Likewise, at the opposite end, where the defendant derives little to no gain from the offense, this will typically indicate a lesser degree of culpability.\textsuperscript{84} On the same note, where the defendant personally gains as a direct result of the offense, this will also be relevant to assigning a culpability level.\textsuperscript{85} However, a small amount of personal gain in relation to the amount of loss does not always indicate a lower level of culpability.\textsuperscript{86}

The defendant’s degree of sophistication or organization of the crime is also considered for culpability purposes. Generally, where the crime is of a higher level of sophistication, it follows that the defendant receives a higher level of culpability.\textsuperscript{87} The opposite is also true: Where the crime is carried out in a simple manner without a high degree of organization, this reflects a lower level of culpability for the offender.\textsuperscript{88} The next factor, duration, follows the same general principles as the degree of sophistication of the crime. A longer duration of the crime (several months) indicates a higher degree of culpability for the defendant.\textsuperscript{89}

\textsuperscript{80} Id. An example would be making a false statement for the purpose of obtaining a bank loan that is intended to be repaid. Id.

\textsuperscript{81} Id.

\textsuperscript{82} Id.

\textsuperscript{83} Id.

\textsuperscript{84} Id. at 4.

\textsuperscript{85} Id.

\textsuperscript{86} Id. “For example, a defendant who intentionally inflicts a large loss on others for the purpose of achieving a small gain would be more culpable with respect to the gain factor than someone who did not intend the loss.” Id. This is likely because of the intent element being present, coupled with motive, even where the gain to the defendant is little to none.

\textsuperscript{87} Id.

\textsuperscript{88} Id.

\textsuperscript{89} Id.
Another factor to consider for culpability levels is whether there were any extenuating circumstances surrounding the commission of the crime. The most notable would be coercion or duress. Following the same general principles as the factors above, a defendant’s culpability will be affected by the nature of any extenuating circumstances.90

The last consideration that is relevant to culpability is any effort to mitigate the harm stemming from the offense. This may include voluntary cessation of the crime, self-reporting, or restitution.91 Where there is evidence of mitigating factors, the defendant’s level of culpability will typically decrease.92 Even where the defendant’s mitigating efforts do not rise to the level of a valid legal defense, the court may still take his efforts into consideration to determine his level of culpability.93

In addition to points being added to the defendant’s offense level for loss and culpability, points may also be added due to the loss incurred by the victim. The Guidelines first take into account how many victims were involved as a result of the offense, and whether the victim(s) suffered a substantial financial hardship.94 Where there are a higher number of victims involved, and where those victims suffer a substantial financial hardship, the defendant’s offense level will be increased.95

Other factors taken into consideration within victim impact include: vulnerability of victims, other non-economic harm, and victim inducement of offense. Where the defendant targeted victims because of some vulnerability, the defendant’s offense level will be increased.96 This tends to go hand in hand with motive and culpability.97 Where the victim(s) suffer some non-economic injury, such as a personal injury, this may not be measurable, or reflected, in the Guidelines “loss” table. Thus, the Guidelines may underestimate the seriousness of the offense in some cases. The court must therefore take into consideration the victim’s non-economic harm, if any.98 Lastly, in some cases, the victim may have contributed to the

90. *Id.* at 5.
91. *Id.*
92. *See id.*
93. *Id.*
95. *See id.; see also* AM. BAR ASS’N, *supra* note 63, at 5.
96. AM. BAR ASS’N, *supra* note 63, at 5.
97. *See id.* at 3.
98. *See id.* at 5.
crime in some manner—e.g., by inducing the commission of the crime or engaging in some lesser degree of culpable conduct. 99 If the victim at all contributed to the crime, it may be appropriate to discount the impact of the victim, and potentially decrease the severity of the offense for the defendant. 100

In recent years, even before the proposed changes to the Guidelines were made, convictions for some white-collar criminals resulted in punishments that were comparable to life sentences. 101 This could be the case even for a first time offender who posed little to no threat to public safety. Corporate accounting fraud and insider trading have resulted in some of the harshest penalties that the Guidelines recommend. 102 While insider trading offenses rarely cause calculable and material loss to individual investors, this mitigating factor seems to be largely ignored when it comes to sentencing such offenders.

The reality is that the sentences for insider trading have been increasing. 103 Reuters conducted a five-year study ending in December 2013 that showed that insider trading defendants “received an average sentence of 17.3 months, up from 13.1 months during the previous five years, or a 31.8[\%] increase.” 104 The Reuters study, which focused only on insider trading, also follows the general trend: The average sentence in federal courts for § 2B1.1 offenders (which includes fraud and other economic crimes) has steadily increased over the last five years. 105 The reason for the increasing sentences seems to be a more general trend towards longer prison terms as evidenced by the recent amendments in the Guidelines. The trend toward longer sentences for white-collar crime

99. See id. at 6.
100. See id.
101. See infra Section IV.A.
102. Henning, supra note 27.
103. Id.
is also thought to be driven in part by the bigger profits being earned through the illegal schemes, even where the victims experience no significant losses.\textsuperscript{106}

Each American state has discrete laws relating to white-collar offending. Generally, the relevant sentencing provisions in the five largest U.S. states by population—California, Texas, Florida, New York, and Illinois\textsuperscript{107}—are less prescriptive than in the federal jurisdiction.

In California, while the amount of loss is the largest consideration in determining a sentence, there are several other factors that affect the outcome of white-collar offenses. One major factor California state courts consider is whether the white-collar offender has committed a “pattern of related felony conduct.”\textsuperscript{108} Under California Penal Code § 186.11, this enhancement is known as the aggravated white-collar crime enhancement.\textsuperscript{109} The amount of time added to the sentence hinges on how much loss was involved in the crime.

California state courts recognize a number of mitigating factors for white-collar offenders. An important consideration is whether the offender voluntarily disclosed the crime.\textsuperscript{110} An offender who self-surrenders in a California state court will receive more leniency than he would in a federal court.\textsuperscript{111}

The precise location where the crime was committed may play a role as a factor in sentencing. If the crime was committed in a county with a rigid district attorney’s office, the prosecutor may be prohibited from suggesting a lighter sentence due to office policies. If it is a high-profile offense, then public pressure may also tie into the mix, making the chances for a light sentence unlikely.\textsuperscript{112}

The second largest state is Texas. Under the Texas Penal Code, Chapter 12 outlines the punishments and penalties for white-collar offenders.\textsuperscript{113} Texas, much like California and the federal jurisdiction, focuses on the same main three principles discussed above.

\begin{itemize}
\item \textsuperscript{106} Reuters Analysis, supra note 104; Henning, supra note 27.
\item \textsuperscript{108} CAL. PENAL CODE § 186.11 (West 2012).
\item \textsuperscript{109} Id.
\item \textsuperscript{111} Id.
\item \textsuperscript{112} Id.
\item \textsuperscript{113} TEX. PENAL CODE ANN. § 12.51 (West 2015).
\end{itemize}
However, Texas state courts apply additional principles for sentencing white-collar crime offenders. While Chapter 12 of the Texas Penal Code defines the basic statutory penalties, Texas state courts may depart from these guidelines. An additional consideration that may aggravate white-collar sentences in Texas is the nature of the victim. Thus crimes committed against vulnerable victims are deemed to be more serious.

The third largest state by population is Florida. While the first two states discussed generally focus mostly on the three main factors (loss, culpability, and victim impact), Florida relies more heavily on victim impact than any other factor. There is a detailed legislative framework dealing with this consideration. Due to the frequency with which victims are deceived and cheated by criminals who commit nonviolent frauds, frequently through the use of the Internet and other electronic technology, the Florida Legislature created and enacted the White Collar Crime Victim Protection Act. The purposes of the White Collar Crime Victim Protection Act are to enhance the sanctions imposed for nonviolent frauds and swindles, protect the public’s property, and assist in prosecuting white-collar criminals.

Under the White Collar Crime Victim Protection Act, an offender commits an “aggravated white collar crime” when he “engag[es] in at least two white-collar crimes that have the same or similar intents, results, accomplices, victims, or methods of commission, or that are otherwise interrelated.” Thus, this statute is geared towards crimes that encompass larger schemes involving fraud, rather than isolated incidents.

Next is New York, the fourth largest state. New York’s Penal Law breaks down each type of white-collar crime and the elements of each offense with greater particularity than the other jurisdictions. New York’s overall sentencing structure is also notable. Two types of sentences are possible, depending on the type of crime committed; either a “determinate” or an “indeterminate” sentence may be imposed. Determinate sentences are fixed and

114. See id. § 12.42.
115. Id.
117. Id.
118. Id. § 775.0844(4).
119. New York Penal Law encompasses many sections dealing with types of white-collar crimes. For a more in depth review of the offenses, see N.Y. Penal Law §§ 155-158, 170-177, 180-190 (McKinney 2016).
cannot be changed by a parole board or any other agency. Indeterminate sentences occur when the judge sets a range and parole boards subsequently determine when, within the given range, the offender is ready to be released from prison.

Over time, the New York State Legislature has reformed its sentencing structures and has ultimately switched which crimes fall into each respective type of sentence. The Legislature determined that first-time and second-time felons who were convicted of violent felonies, drug offenders, and sex offenders whose felonies are non-violent all fall into a determinate sentence. Over time, the New York State Legislature has reformed its sentencing structures and has ultimately switched which crimes fall into each respective type of sentence. The Legislature determined that first-time and second-time felons who were convicted of violent felonies, drug offenders, and sex offenders whose felonies are non-violent all fall into a determinate sentence. This left a category of some 200 offenses falling into an indeterminate sentence. Crimes that have an indeterminate sentence include non-violent, non-drug, and non-sex offenses, such as grand larceny, which is a white-collar crime. Thus, because white-collar crimes fall into the indeterminate sentencing category, New York has a broad discretion in considering factors at sentencing for white-collar crime offenders.

In New York, crimes are categorized into alphabetical classes “A” through “E.” The higher the class (such as “Class A”), the longer the minimum and maximum sentences that may be imposed. In regard to white-collar crimes, New York focuses mostly on economic loss, or the amount of money stolen. The amount of money stolen in a fraud scheme, for example, will determine the class in which the crime will be categorized. Where the offender steals property valued over one thousand dollars, he has committed larceny in the fourth degree, and this is a Class E felony. New York has different degrees of larceny, with the most severe being larceny in the first degree, which is where the offender

121. *See id.* at 2-3.
122. *Id.* at 3.
123. *Id.* at 4.
124. *See id.* at 6-7.
126. *N.Y. Penal Law* § 155.30 (McKinney 2010). Note that where the offender steals less than one thousand dollars, this is considered petit larceny, and is a Class A misdemeanor. *Id.* § 155.25.
steals over one million dollars, and this is a considered a Class B felony.\textsuperscript{127}

Thus, when larger sums of money are stolen, the offense will be placed into a higher class and the offender will receive a longer sentence. Likewise, where there is less money stolen, the crime will be placed into a lower class and the offender will have a shorter sentence. Because of the different degrees of crimes, and different classes, New York’s main focus in sentencing for white-collar crimes is on the economic loss sustained.

Additionally, much like Florida, the state of New York takes into consideration the age of the victim.\textsuperscript{128} Fraud against the elderly is a growing problem in the United States, and especially in New York, which has the third-largest older adult population in the country.\textsuperscript{129}

Lastly, the fifth largest state is Illinois, which has several state statutes that govern white-collar crimes. These statutes set forth the crimes that are included as white-collar crimes, as well as the elements of each offense.\textsuperscript{130} Similar to a few states above, Illinois mainly focuses on the dollar value of the property that was stolen.\textsuperscript{131} This encompasses the overarching factor of economic loss, but is more specific to the dollar amount lost. Not surprisingly then, the more money or value that was stolen through white-collar crime, the longer the sentence will be for the offender.\textsuperscript{132} However, the actual value at issue can be hard to determine, and there may be disputes over what certain property is worth.

Illinois also focuses on a few other factors when dealing with sentencing white-collar crime offenders. Much like Florida, the state of Illinois will enhance a sentence for a white-collar crime where the offender committed the crime against a person age sixty or older.\textsuperscript{133} Illinois may also consider whether the offender stole from the government, from a school, or a place of worship and use these factors in sentencing.\textsuperscript{134}

\begin{footnotes}
\item[{127}] Id. § 155.42 (McKinney 1986).
\item[{128}] WHITE COLLAR CRIME TASK FORCE, supra note 125, at 62.
\item[{129}] Id.
\item[{130}] See Ch. 720 ILL.COM.P. STAT. ANN. 5/33-1 to -8 (West 2012); Ch. 720 ILL.COM.P. STAT. ANN. 5/16 (West 2012).
\item[{132}] See id.
\item[{133}] Id.
\item[{134}] Id.
\end{footnotes}
Thus, the federal jurisdiction and the five largest U.S. states generally consider three main overarching factors at sentencing: (1) economic loss, (2) culpability, and (3) victim impact. However, there is a degree of divergence regarding the precise considerations that can aggravate and mitigate penalties for white-collar offenders.

Thus, there is a considerable degree of convergence regarding the main considerations that in theory drive sentencing determinations in the relation to insider trading offenses. At the edges there are, however, differences regarding the precise factors that aggravate and mitigate penalties for such offenses, and there are also differences regarding the manner in which the concrete penalties for insider trading offenses are determined. As we have seen, some jurisdictions, such as the federal jurisdiction, have guideline penalties, while in other states the parameters of an appropriate penalty are less prescriptive.\textsuperscript{135} Despite this, the overwhelming trend relating to insider trading offenses is that the penalties are increasing. Moreover, the key rationales for the tough penalties (in the form of general deterrence and the desire to protect the integrity of the market) are uniform. It is to these considerations that we now turn.

C. United States Insider Trading: Examples of Heavy Penalties

As we have seen, there is a degree of divergence in the various American jurisdictions regarding the exact considerations that inform sentences for insider trading offenses; however, a universal theme is that these offenses are generally punished severely. The post-2000 insider trading cases that attracted the heaviest penalties are as follows:

\textsuperscript{135} In California, where an offender engages in market manipulation, insider trading, or makes a false or misleading statement in a securities transaction, the penalties include up to $10,000,000 in fines and/or two, three, or five years in county jail. \textsc{Cal. Corp. Code} § 25540(b) (West 2011). In Texas, a white-collar offender may be charged with a felony in the first degree, which carries a maximum penalty of not more than ninety-nine years and not less than five years. \textsc{Tex. Penal Code Ann.} §§ 12.32, 34.02 (West 2015). In Florida, a white-collar crime constituting a felony in the first degree carries a maximum penalty of up to thirty years imprisonment. \textsc{Fla. Stat. Ann.} § 775.082(3)(b)(1) (West 2016). In New York, the maximum penalty for someone who commits a white-collar crime is twenty-five years and is a Class B felony. \textsc{N.Y. Penal Law} § 155.42 (McKinney 1986); \textit{Id.} § 70.00(2)(b) (McKinney 2009). Lastly, in Illinois, an offender who steals property or money over $10,000 has committed a Class 1 felony, which carries a maximum sentence of fifteen years. \textsc{Ch. 730 Ill. Comp. Stat. Ann.} 5/5-4.5-30(a) (West 2012).
The above discussion and illustrative sentences set out the precise considerations that inform the sanction that is imposed in a particular insider trading case and, as we have seen, considerations relating to the monetary amount and culpability are paramount. Underlying these considerations are the rationales for harsh sentences for offenders who commit insider trading offenses. To this end, there are two common justifications that are often invoked to justify stern penalties in such cases. The first is general deterrence. To this end, in United States v. Gupta it was noted:
As to specific deterrence, it seems obvious that, having suffered such a blow to his reputation, Mr. Gupta is unlikely to repeat his transgressions, and no further punishment is needed to achieve this result. General deterrence, however, suggests a different conclusion. As this Court has repeatedly noted in other cases, insider trading is an easy crime to commit but a difficult crime to catch. Others similarly situated to the defendant must therefore be made to understand that when you get caught, you will go to jail. Defendant’s proposals to have Mr. Gupta undertake various innovative forms of community service would, in the Court’s view, totally fail to send this message. Moreover, if the reports of Mr. Gupta’s charitable endeavors are at all accurate, he can be counted on to devote himself to community service when he finishes any prison term, regardless of any order of the Court.136

Similarly, in SEC v. Happ, the First Circuit discussed general deterrence as it relates to insider trading:

The Insider Trading and Securities Fraud Enforcement Act (“ITSFEA”) authorizes courts to impose a penalty of up to “three times the profit gained or loss avoided” as a result of the insider trading. ITSFEA civil penalties were enacted to “enhance deterrence against insider trading, and where deterrence fails, to augment the current methods of detection and punishment of this behavior.” We review an order imposing a civil penalty for abuse of discretion. A court may consider several factors in evaluating whether or not to assess civil penalties, such as: (1) the egregiousness of the violations; (2) the isolated or repeated nature of the violations; (3) the defendant’s financial worth; (4) whether the defendant concealed his trading; (5) what other penalties arise as the result of the defendant’s conduct; and (6) whether the defendant is employed in the securities industry.137

The court assessed the above factors and ultimately acted within its discretion to impose a civil penalty on the defendant, “not only to punish him but to serve as a deterrent on insider trading generally.”138

The other common rationale invoked in sentencing insider trading offenders is the supposed need to protect the integrity of and investor confidence in the market. For example, in United States v. Goffer,139 the United States Court of Appeals (Second Circuit) stated that “[i]n light of the magnitude of his insider trading, which had major deleterious effects on the market, Drimal was no small-time criminal.”140

Similarly in United States v. Kurland, the Court stated:

137. SEC v. Happ, 392 F.3d 12, 32 (1st Cir. 2004) (citations omitted).
138. Id. at 33.
139. United States v. Goffer, 721 F.3d 113 (2nd Cir. 2013).
140. Id. at 132.
Mr. Kurland’s actions, stemming from a recognized leader of the industry, compromised the financial market’s integrity at a time of financial crises and widespread concern about corruption, rampant recklessness, and arrogant greed at the highest levels of the industry, a culture of oblivion to the meaning of reasonable limits that contributed significantly to bring about the worst economic collapse in the country since the Great Depression.\(^{141}\)

We now consider United States sentencing law and practice in relation to market manipulation offenses.

D. Sentencing Law in the United States: Market Manipulation Offenses

While the concept of market manipulation or abuse is not expressly or statutorily defined in the United States, it is commonly known as an attempt to artificially raise or lower the price of stock on any national securities or commodities exchange, or in the over-the-counter marketplace, i.e., a deliberate interference with the open market.\(^{142}\)

In the United States, there has been legislation to combat offenders who manipulate the market. The Securities Exchange Act of 1934 prohibits the making of corporate misstatements that will lead to the defrauding of innocent investors.\(^{143}\) As we have seen, this Act expressly prohibits market manipulation and prohibits a person from willingly creating misleading or false appearances in securities listed on a stock exchange.\(^{144}\) Further, this Act prohibits a person from directly or indirectly using deceptive devices to purchase or sell any listed securities to the detriment of investors.\(^{145}\)

Where an offender commits a market manipulation offense, there are a variety of penalties available, including criminal, civil, and administrative sanctions.\(^{146}\) Market manipulation offenders are subject to the general sentencing principles in the United States. However, there are several sentencing factors that apply more


\(^{144}\) Id.

\(^{145}\) Id.

\(^{146}\) Id. at 129.
commonly for someone who commits a market manipulation offense. As previously discussed, the Federal Sentencing Guidelines provide the framework for the sentencing of market manipulation offenders. As compared to white-collar crime in general, there are some particular considerations that apply to market manipulation offenses.

Since market manipulation involves the deliberate interference with the market, it follows that the offender committed the offense knowingly. Thus, the court will focus more heavily on factors such as where the offender knowingly violates market manipulation provisions, or where an offender willfully or intentionally engages in prohibited trade practices.\(^{147}\) Other sentencing factors include whether the offender willfully or recklessly aided, abetted, counseled, commanded, or induced another person to commit market abuse practices.\(^{148}\) Those offenders who willfully aid others typically constitute an aggravating factor at sentencing.

In the United States, there have been several large, highly publicized cases involving market manipulation. The most widely known case involves the Enron scandal that began in late 2001.\(^{149}\) Enron was a company located in Texas that primarily marketed electricity and natural gas and delivered energy and other physical commodities. Enron was once ranked the sixth largest energy company in the world, until it was revealed that most of the top executives were tried for fraud after a formal investigation revealed that Enron’s earnings had been overstated by several hundred million dollars.\(^{150}\) Top executives were manipulating the market by misrepresenting earnings reports while continuing to enjoy the revenues provided by the investors who were not made aware of the true financial condition of Enron.\(^{151}\) The funds being stolen from the company resulted in bankruptcy for Enron. The Securities and Exchange Commission (SEC) and the U.S. Department of Justice launched a formal investigation into Enron and many of the top executives of the company were arrested.

The two most notable executives from the Enron scandal were punished the most severely. Kenneth Lay was CEO of Enron from


\(^{148}\) See id. §§ 32(a), 24.


\(^{151}\) See id.
1985 to 2000, and then Jeffrey Skilling took over for a year. Skilling resigned as CEO in August 2001, and Lay was reinstated as CEO again. Skilling was indicted on nineteen counts of fraud and conspiracy, while Lay was indicted on eleven counts. The jury in the Enron case found Jeffrey Skilling and Kenneth Lay guilty of conspiracy and fraud. Approximately two months after the verdict, Kenneth Lay died and did not receive a sentence before his death. The United States District Court for the Southern District of Texas sentenced Skilling to 292 months of imprisonment (or 24 years and 4 months) and three years of supervised release, and assessed $45 million in restitution. He then appealed his conviction and, in 2013, a federal judge reduced his sentence by more than ten years.

Another widely known market manipulation case in the United States involved the company WorldCom. The company was recording its operating expenses as investments and exaggerated profits in 2001 by inflating assets. WorldCom was ultimately caught for stock market manipulation by its own internal auditing department early in 2002. WorldCom’s CFO Scott Sullivan and CEO Bernard Ebbers were indicted on charges of fraud. CFO Sullivan entered a guilty plea in exchange for a lighter sentence and received only five years in prison. However, CEO Ebbers was

152. Id.
153. Id.
154. Id. Lay was indicted for one count of conspiracy to commit security and wire fraud, two counts of wire fraud for misleading statements at employee meetings, four counts of securities fraud for false statements in presentation to securities analysts, one count of bank fraud, and three counts of making false statements to banks. Id.
155. Id.
156. United States v. Skilling, 638 F.3d 480, 481 (5th Cir. 2011).
159. Id.
sentenced to twenty-five years in prison for his role in “orchestrating the biggest corporate fraud in the nation’s history.”

Adelphia Communications is another highly publicized market manipulation case. Prior to the scandal, Adelphia was one of the nation’s largest cable TV companies. John Rigas was the founder and owner of Adelphia, who was the driving force behind the eventual scandal. John Rigas and other family members were found to have been “regularly conducting their business activities with the sole purpose of benefitting themselves at the expense of Adelphia and borrowed company funds that either directly or indirectly, unjustly enriched the Rigas family.” The Rigases used company jets for private trips, borrowed billions of dollars for their closely held companies, and used $252 million of company funds to meet margin calls on their private stock.

The New York Times noted that this scandal is distinguishable from virtually every other market manipulation case for one reason—the Rigases didn’t sell their stock.” It added, “[t]he evidence suggests less that they intended to defraud than that they intended to hide inconvenient facts until they could be righted. This is also, of course, against the law; it’s just a more tragic crime than ordinary looting.” Ultimately, owner John Rigas was sentenced to fifteen years and his son Timothy Rigas was sentenced to twenty years in prison for multiple charges of securities fraud, conspiracy to commit bank fraud, and bank fraud.

Another highly publicized, well-known market manipulation/stock fraud scandal involved Charles E. Johnson, founder and CEO of now-defunct PurchasePro Incorporated. Johnson was the ringleader of a scheme to falsely inflate PurchasePro’s revenue in the

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163. Id.


165. Id.

first quarter of 2001.\textsuperscript{167} Seven people were convicted in this investigation, “which also exposed improper accounting practices at America Online [(AOL)], which had been PurchasePro’s business partner” at the time.\textsuperscript{168} Johnson’s scheme included inflating the company’s revenue to meet the expectations of Wall Street, falsifying and backdating contracts, and entering into secret side deals with AOL.\textsuperscript{169} Johnson was convicted of stock fraud, witness tampering, and obstruction of justice.\textsuperscript{170} Prosecutors recommended Johnson serve between 16 and 17.5 years in jail.\textsuperscript{171} However, U.S. District Judge Liam O’Grady ruled that because Johnson’s crimes occurred more than seven years prior, Johnson should be sentenced under older federal guidelines, which called for a lesser sentence.\textsuperscript{172} Johnson was ultimately sentenced to 9 years in prison, which was much less than what had been recommended.\textsuperscript{173}

The above discussion of market manipulation cases sets out some examples of the most serious offenses of this nature in order to textualize the nature of the offending. More comprehensively, the post-2000 market manipulation cases that attracted the heaviest penalties are set out in the following table:

<table>
<thead>
<tr>
<th>Case Name and Court</th>
<th>Date of Sentence</th>
<th>Sentence (length of imprisonment)</th>
</tr>
</thead>
</table>

\textsuperscript{168} \textit{Id}.
\textsuperscript{169} \textit{Id}.
\textsuperscript{170} \textit{Id}.
\textsuperscript{171} \textit{Id}.
\textsuperscript{172} \textit{Id}.
\textsuperscript{173} \textit{Id}.
<table>
<thead>
<tr>
<th>Case</th>
<th>Date of Sentence</th>
<th>Jail Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. U.S. v. Scrushy (HealthSouth scandal) [Unreported, U.S. District Court, M.D. Ala.]</td>
<td>June 28, 2007</td>
<td>6 years and 10 months</td>
</tr>
<tr>
<td>6. U.S. v. Skilling (Enron scandal) [Unreported, U.S. District Court for the S.D. Tex.]</td>
<td>October 23, 2006</td>
<td>24 years and 4 months</td>
</tr>
<tr>
<td>9. U.S. v. Rigas, No. 02 Cr. 1236 (LBS), 2008 WL 2544654 (S.D.N.Y. June 24, 2008)</td>
<td>June 27, 2005</td>
<td>12 years (John Rigas) and 17 years (Timothy Rigas)</td>
</tr>
</tbody>
</table>
As with insider trading, two key considerations that the courts invoke to justify harsh penalties for insider trading offenses are general deterrence and the damage to the integrity or confidence in the markets.174

In United States v. Castaldi, “defendant Frank Castaldi made an entire career out of a Ponzi scheme” and was convicted, upon a guilty plea, of mail fraud and corruptly impeding the IRS.175 In determining his sentence, the court addressed deterrence, both specific and general, and held that a Guideline sentence would not be adequate as a deterrent to this crime.176 The court considered all the mitigating factors that the defense had set forth in its memorandum.177 “The sentence was the longest possible under the plea agreement: maximum consecutive sentences for a total of 276 months (twenty-three years) in prison.”178

Likewise, in United States v. Martin, the court heavily considered general deterrence as a factor in its holding.179 In the lower district court, the defendant pled guilty to conspiring to commit securities and mail fraud.180 The district court made a substantial departure (23 levels) from the sentencing guidelines and imposed probation.181 The government appealed the extent of the departure and the case was vacated and remanded. On remand, the district court imposed a sentence of seven days.182 The government again appealed. The Eleventh Circuit weighed in on deterrence: “[T]he 7-day sentence imposed by the district court utterly fails to afford adequate deterrence to criminal conduct [b]ecause economic and fraud-based crimes are ‘more rational, cool, and calculated than sudden crimes of passion or opportunity,’ these crimes are ‘prime candidate[s] for general deterrence.’”183 The view was taken that white-collar crime defendants will typically weigh financial gain and risk of loss, and thus, white-collar crime can be affected and reduced with serious punishment through deterrence.184 Accordingly, the

175. 743 F.3d 589 (7th Cir. 2014).
176. Id. at 594.
177. Id.
178. Id. at 594-95.
179. 455 F.3d 1227, 1240 (11th Cir. 2006).
180. Id. at 1229.
181. Id. at 1233.
182. Id.
183. Id. at 1240 (citations omitted).
184. See id.
Eleventh Circuit vacated Martin’s sentence and remanded the case for resentencing in a manner consistent with the Supreme Court’s decision in *Booker*.

In *SEC v. Lorin*, the court expressly raised the concept of general deterrence:

Disgorgement is an equitable remedy that does not compensate investors but rather is “designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws.” In view of the fact that the Court has found Capital Shares, Caiito, and Ruggiero to have violated Sections 17(a) of the Act of 1933 and Section 10(b) of the Exchange Act, disgorgement is an appropriate remedy to preclude the unjust enrichment of these defendants, as well as to serve both specific and general deterrence purposes.

The Second Circuit Court of Appeals in *Reddy v. Commodity Futures Trading Commission* noted that the offender’s conduct was “serious, repetitive, and affected the integrity of the market. . . . and such misconduct, when detected, must be heavily punished if deterrence is to be achieved.” The court went on to state that the amount of penalties per violation must have a rational relationship to the offense and in offenses of this type the integrity of the market is an important consideration. The court stated:

It is certainly reasonable to measure the gravity of the violations by “the betrayal of public interest” and by the need to deter threats to the integrity of the markets, and “the calculation of civil money penalties does not lend itself to simple formulaic solutions” . . . we conclude that the civil monetary penalties here were rationally related to the misconduct.

Further, the Supreme Court has adopted a “presumption of reliance” and the Court assumes that buyers and sellers rely not just on the market price, but also on the integrity of that price. Notably, this is an assumption only and, as we discuss below, is not validated by empirical evidence.

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185. *Id.*


188. *Id.* at 128 (quoting *In re* Grossfeld, 1996 WL 709219, at *12 (C.F.T.C. 1996)).

E. Sentencing Law in Australia: An Overview

Sentencing law differs in each Australian jurisdiction (the six states, the Northern Territory, the Australian Capital Territory, and the federal jurisdiction). However, there is considerable convergence in relation to a number of key areas. All Australian jurisdictions pursue the same fundamental objectives of sentencing, in the form of incapacitation (also referred to as community protection), general deterrence, specific deterrence, rehabilitation, and retribution—as is the situation in the United States.

Sentencing judges in Australia have wide discretion regarding choice of penalty. Fixed penalties for serious offenses in Australia are rare. The reasoning process that judges undertake in making sentencing decisions is known as the “instinctive synthesis,” pursuant to which sentencers make a decision regarding all of the considerations that are relevant to sentencing and then give due weight to each of them (and, in the process, incorporate considerations that incline to a heavier penalty and offset against the factors that favor a lesser penalty) and then set a precise penalty. “The hallmark of this process is that it does not require (nor permit) judges to set out with any particularity the weight (in mathematical terms) accorded to any particular consideration.” “Under this model, courts can impose a sentence within an ‘available range’ of penalties.” The spectrum of this range is not clearly defined.

A defining aspect of Australian sentencing law is the large number of considerations (more than 200) that can either mitigate or aggravate a penalty. There are four categories of mitigating

191. Id.
192. Id. at 1191.
193. Id. at 1181-82.
194. Id. at 1182.
195. Id.
197. Id. at 80.
factors.\textsuperscript{199} The first are those relating to the offender’s response to a charge and include pleading guilty\textsuperscript{200} and remorse.\textsuperscript{201} The second category consists of factors that relate to the circumstances of the offense and which contribute to, and to some extent explain, the offending. These include mental impairment\textsuperscript{202} and provocation.\textsuperscript{203} The third category relates to matters that are personal to the offender, such as youth\textsuperscript{204} and good prospects of rehabilitation.\textsuperscript{205} The impact of the sanction is the fourth broad type of mitigating factor, and includes considerations such as onerous prison conditions\textsuperscript{206} and public opprobrium.\textsuperscript{207} Additionally, there are also a large number of aggravating factors, including prior criminal record, offending committed while on bail,\textsuperscript{208} and breach of trust.\textsuperscript{209}

F. Sentencing Law in Australia: Insider Trading Offenses

Within this rubric, sentencing principles relating to white-collar crime are largely open-ended, but in practice there are a number of widely accepted and observed rules. White-collar offenses are

\begin{itemize}
\item \textsuperscript{200} See Cameron v The Queen (2002) 209 CLR 339 (Austl.).
\item \textsuperscript{207} Ryan v The Queen (2001) 206 CLR 267, 279 (Austl.).
\end{itemize}
generally regarded as often being committed for greed;\textsuperscript{210} thus, a paramount consideration in sentencing is the amount of money involved.\textsuperscript{211} Other important considerations are the level of sophistication and planning of the offense\textsuperscript{212} and whether or not a breach of trust occurred.\textsuperscript{213} Offenses committed over a long period of time are normally considered to be more serious.\textsuperscript{214}

The cardinal sentencing consideration regarding white-collar offenses is general deterrence.\textsuperscript{215} This is especially the situation in relation to insider trading offenses. In relation to such offenses, another key consideration is the supposed damage that insider trading offenses do to the market. In \textit{R v Bateson}, Judge Buddin provided an extensive analysis of the principles guiding sentences for insider trading offenses. In the passage below, His Honour emphasizes the importance of general deterrence and damage to the market system. In terms of the general principles, His Honour stated:

The principles which are applicable to sentencing for offences of insider trading were conveniently stated in \textit{R v Rivkin} [2002] NSWSC 1182; (2003) 198 ALR 400, in which Whealy J, as His Honour then was, said that:

“[T]he element of general deterrence is important in white collar crimes. It is of course, an important part of the sentencing process in all crimes. It is however, an especially important matter in crimes such as the present


\textsuperscript{213} DPP v Penny [2012] VSCA 203 (Austl.); Porcaro v The Queen [2015] VSCA 244 (Austl.).


because of the need to mark out plainly to others who might be minded to breach their professional or related obligations that such conduct will generally merit, in appropriate cases, condign punishment.

An important reason why this is so relates to the often remarked difficulty in detecting and investigating white collar crime. Insider trading is particularly hard to detect. It may often go unnoticed but where it occurs it has the capacity to undermine to a serious degree the integrity of the market in public securities. It has the additional capacity to diminish public confidence not only so far as investors are concerned but the general public as well. Moreover, this diminution in confidence may occur subtly and is not confined to the circumstances where a substantial insider trading transaction has taken place. There is a capacity to undermine and diminish public confidence in the market even where the offence may be shown as one which in some respects occupies a lower level of seriousness. This is likely to be particularly so in the case of an offender who occupies a substantial position as a trader and advisor in the market.”

. . . .

The damage caused by insider trading was described by the Court of Criminal Appeal in \textit{R v Rivkin} [2004] NSWCCA 7; (2004) 184 FLR 365 in the following terms:

“Nor is it correct to describe the offence . . . as ‘victimless’. The victim of any such offence is the investing community at large, the injury being that related to the loss of confidence in the efficacy and integrity of the market in public securities.”

In \textit{R v Firns} (2001) 51 NSWLR 548; [2001] NSWCCA 191 Mason P observed that:

“On this approach, equality of access to the relevant market is the critical factor. Under this theory, restrictions on insider trading are designed to ensure that the market operates fairly, with all participants having equal access to relevant information. The playing field is to be levelled.”

. . . .

In \textit{Director of Public Prosecutions} \textit{v O’Reilly} [2010] VSC 138, T Forrest J said that:

“[I]n insider trading cases I consider there are at least two victims; the seller or sellers of the stock at the lower price and the public, whose confidence in the integrity of the market must be diminished. The impact upon public confidence in the market is an important factor. The securities markets could not survive and flourish without the confidence of those who elect to invest in it.”

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In *Hartman v Director of Public Prosecution (Cth)*,217 the court allowed an offender’s appeal against his sentence—essentially on the basis of his mental illness—for a number of insider trading offenses (contrary to §§ 1043A(1), 1043A(2), and 1311(1) of the *Corporations Act 2001* (Cth)). In doing so, the court emphasized the importance of general deterrence in relation to such offenses. The court also held that trading in off-market derivatives is no less serious because of the damage to the institutional integrity of the markets. The court stated:

> It needs to be remembered that insider trading not only has the capacity to undermine the integrity of the market, it also has the potential to undermine aspects of confidence in the commercial world generally.218

The supposed harm caused to the markets by insider trading is more recently noted in *Director of Public Prosecutions (Cth) v Couper*, where the court stated:

> As the Honourable Justice McClellan, speaking extra-judicially, said:

> “When assessing the seriousness of a crime involving violence to an individual, the extent of the harm occasioned to the victim is a significant matter. The sentence may vary depending upon the nature and extent of the injuries inflicted on the victim. White-collar crime also impacts upon victims, sometimes many, but usually lacks any physical violence. Although mostly confined to a loss of money, that loss may have a devastating consequence for the wellbeing of the individual. Identifying and weighing the harm may prove difficult. When a market is manipulated, the loss to a particular individual may be impossible to identify.

> . . . .

> Both white-collar and financial crime have the capacity to do great harm to many members of the community. Apart from financial loss the psychological harm to an individual in the form of stress and anxiety may be significant. By its nature, white-collar or financial crime may be hard to discover, and the victims’ losses may be difficult to ascertain and quantify. The offender may have a multitude of victims. The crime may affect the Australian economic ‘brand’ and its desirability as a place to invest. This may be contrasted with offences involving property damage, larceny or robbery where the damage is likely to be confined to an individual victim or a small group of victims. The harm inflicted by insider trading and other market-related offences will be greater both in absolute terms and in respect of the number of victims than many other white-collar crimes and the more common offences. In its ‘rawest form, insider trading dislocates the market. It upsets overseas investors’. Similarly, ‘the vast majority of shareholders suffer. They miss out on value . . .’. Victims of insider

218. *Id.* at *21.
trading include “‘Mums and Dads’, investors, small traders, and those
who do not have the information and trade in that state of ignorance’.
Indeed, it is generally the ‘people on the outer ring of the market’, such as
retirees and the like, who are particularly disadvantaged.”

G. Insider Trading in Australia: Examples of Heavy Penalties

The culmination of the application of the above principles to
the sentencing of insider trading offenders is generally severe
penalties. However, the length of prison terms is typically shorter
than in the United States. Set out below are the nine highest
sentences for insider trading offenses in Australia post-2000:

<table>
<thead>
<tr>
<th>Case Name and Court</th>
<th>Date of Sentence</th>
<th>Sentence (length of imprisonment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. <em>Regina v Xiao</em> [2016] NSWSC 240</td>
<td>March 11, 2016</td>
<td>8 years, 3 months</td>
</tr>
<tr>
<td>3. <em>DPP (Cth) v Hill</em> [2015] VSC 86</td>
<td>March 17, 2015</td>
<td>Hill: 2 years Kamay: 7 years</td>
</tr>
</tbody>
</table>


220. There are nine instead of ten, given that the authors could only locate nine such cases that resulted in the imposition of prison terms.
H. Sentencing Law in Australia: Market Manipulation Offenses

The principles regarding market manipulation offenses in Australia are similar to those relating to insider trading offenses, with general deterrence and the supposed damage to the integrity of the market being the two most important sentencing considerations. In *R v Chan* the court stated, in relation to market manipulation offending, that:

The aspect of general deterrence must play a significant role in this sentencing exercise. . . . I consider that it is only by the imposition of such a sentence that others considering manipulating the market in some way will pause to think about the potential consequences of their actions.221

In similar vein, in *R v Jacobson (Sentence)* the court emphasized the need for general deterrence for market manipulation offenders and the reason for this approach. The court stated:

In cases such as this, the courts have emphasised that the principles of general deterrence and denunciation must be given significant weight. It is the common experience of the courts that offences, such as those for which you have been convicted—falling under the general rubric of “white collar” offences—are ordinarily committed by persons who have hitherto been of good character and reputation. Such offences are difficult to detect and to prove. Unless the courts adopt a firm approach in the imposition of sentences for such offences, those persons, who are minded to commit such offences, will consider that the risks in doing so are outweighed by the potential benefits, which may accrue from involvement in such offences. For those reasons, it has been emphasised by the courts that the considerations of denunciation and general deterrence must take precedence, and be given significantly more weight, than the mitigatory factors, to which I have already referred, such as your good character and your health issues.222

In *R v Chan*, the court emphasized the importance of the integrity of the market in relation to market manipulation offenses. It stated:

Section 780A of the Corporations Act states the objects of Ch 7 (which includes [§] 1041A). One is to ensure fair, orderly and transparent markets for financial products. If the markets lack integrity, public confidence in them is necessarily eroded. The object of [§] 1041A is to protect the securities market from “artificial or managed manipulation”. Your conduct in facilitating the efforts of Hal and Ian Christiansen to artificially inflate


the closing price of Bill Express securities therefore must be viewed seriously. The impact of your conduct is not felt merely by those tempted to purchase Bill Express shares in an artificial market or the banks who otherwise would be entitled to a margin call from exposed shareholders; it is felt by the entire securities market, a market that you understood intimately.223

The same sentiment was expressed in *R v Jacobson (Sentence)*, but with even more clarity:

The offences, for which you have been convicted, are serious. The express objective of [§] 1041A of the Corporations Act is to promote a fair, orderly and transparent market for registered securities. As part of that objective, [§] 1041A is directed to ensuring that the market price for registered securities truly reflects the genuine interaction of the forces of supply and demand for those securities on a free market. The conduct, in which you indulged, and to which you were a party, was calculated to undermine that objective. In that way, your conduct had the capacity to erode the integrity of, and public confidence in, the securities market, and thereby to cause damage to members of the community, who have invested their savings in that market.224

The culmination of the application of the above principles to the sentencing of insider trading offenders is generally severe penalties—although again not as severe as in the United States. Set out below are the seven highest sentences for market manipulation offenses in Australia post-2000:225

<table>
<thead>
<tr>
<th>Case Name and Court</th>
<th>Date of Sentence</th>
<th>Sentence (length of imprisonment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Nigel Derek Heath v R [2016] NSWCCA 24</td>
<td>February 25, 2016</td>
<td>3 months of prison + 15 months to be served by way of recognizance order to be of good behavior</td>
</tr>
</tbody>
</table>

225. There are seven instead of ten, given that the authors could only locate seven such cases that resulted in the imposition of prison terms.
<table>
<thead>
<tr>
<th></th>
<th>Case Reference</th>
<th>Date of Judgement</th>
<th>Sentence Details</th>
</tr>
</thead>
</table>
| 2. | *R v Dulhunty; R v PR* [2015] NSWSC 1747 | November 30, 2015 | Dulhunty: 6 months of prison + 1 year to be served by way of recognizance order to be of good behavior  
PR: 6 months of prison + 1 year to be served by way of recognizance order to be of good behavior |
| 3. | *R v Heath* [2015] NSWDC 282 | September 25, 2015 | 9 months of prison + 18 months to be served by way of recognizance order to be of good behavior |
| 4. | *R v Jacobson* [2014] VSC 592 | November 28, 2014 | 1 year of prison + 20 months to be served by way of recognizance order to be of good behavior |
| 5. | *R v Moylan* [2014] NSWSC 944 | July 25, 2014 | 1 year and 8 months of prison + 2 years of recognizance order to be of good behavior |
| 7. | *R v Austin* [2001] NSWSC 484 | June 13, 2001 | 3 years of recognizance order to be of good behavior |
III. DISCUSSION OF THE KEY RATIONALES FOR HARSH SENTENCES FOR INSIDER TRADING AND MARKET MANIPULATION OFFENSES

As we have seen, in pragmatic terms the two key rationales that are advanced for imposing severe punishment on insider trading and market manipulation offenders are general deterrence and the supposed harm their actions cause to the stock market. A closer analysis of these rationales establishes that none of them are defensible—they are all debunked by an empirical analysis. We now elaborate on these observations, starting with general deterrence.

A. The Failure of Marginal General Deterrence

General deterrence seeks to dissuade potential offenders with the threat of anticipated punishment from committing similar offenses by illustrating the harsh consequences of offending.\(^226\) There are two forms of general deterrence. Marginal general deterrence is the view that severe penalties reduce the incidence of crime. It contends that imposing increasingly harsh penalties will reduce crime.\(^227\) Absolute general deterrence is the more modest claim. It concerns the threshold question of whether there is any connection between criminal sanctions, of whatever nature, and the incidence of criminal conduct.\(^228\) Absolute general deterrence does not require or support the imposition of harsh sanctions.\(^229\) In order for it to be effective, any sanction which people find unpleasant (such as a fine) is sufficient. The evidence suggests that marginal deterrence is a flawed theory, while absolute general deterrence does work.\(^230\) There is a large body of literature devoted to this issue. The following is a summary of the major findings.\(^231\)

Marginal general deterrence seems to be flawed in relation to all penalty types. There has been a considerable degree of debate

\(^{226}\) See Franklin Zimring & Gordon Hawkins, Deterrence: The Legal Threat in Crime Control 72 (Sanford H. Kadish et al. eds., 1973).

\(^{227}\) See Bagaric, From Arbitrariness to Coherency in Sentencing, supra note 29, at 382.

\(^{228}\) See Zimring & Hawkins, supra note 226, at 14.

\(^{229}\) See Bagaric, From Arbitrariness to Coherency in Sentencing, supra note 29, at 382.

\(^{230}\) Id. at 394.

\(^{231}\) The findings and discussion regarding general deterrence are discussed in greater detail and derived from Bagaric, From Arbitrariness to Coherency in Sentencing, supra note 29.
regarding the efficacy of capital punishment to deter crime.\textsuperscript{232} However, the weight of evidence and informed sentiment\textsuperscript{233} suggests that there is no firm basis for believing that it even reduces crime. The most wide-ranging recent analysis of the impact of the death penalty on crime is by the National Research Council of the National Academies, which was released in 2012. The report concluded:

The committee concludes that research to date on the effect of capital punishment on homicide is not informative about whether capital punishment decreases, increases, or has no effect on homicide rates. Therefore, the committee recommends that these studies not be used to inform deliberations requiring judgments about the effect of the death penalty on homicide. Consequently, claims that research demonstrates that capital punishment decreases or increases the homicide rate by a specified amount or has no effect on the homicide rate should not influence policy judgments about capital punishment.\textsuperscript{234}

The above conclusions are based on crime data in general. They are not focused on white-collar offending. This is because of the dearth of empirical research that has been undertaken on this specific issue. Yet, it is possible, with some caveats, to extrapolate the results of the general observations to the context of white-collar crimes. Logically, it would seem that in the case of white-collar offenses, general deterrence would be more effective because the offenses are always planned and offenders are better placed to undertake a cost–benefit analysis of their conduct.\textsuperscript{235} This understanding has led to calls for harsher penalties for white-collar


\textsuperscript{234} COMM. ON LAW & JUSTICE, DETERRENCE AND THE DEATH PENALTY, NAT’L RESEARCH COUNCIL 102 (Daniel S. Nagin & John V. Pepper eds., 2012).

offenses. For example, Anna Driggers asserts in relation to the Rajaratnam sentence that the penalty will:

[L]ikely be an effective deterrent. First, Rajaratnam’s sentence will send a message to a specific population of traders, those who consider or engage in insider trading, as they see the zeal of prosecutors and their eagerness to use new investigative techniques. Second, the sentence upholds well-known securities laws and demonstrates the government is serious about enforcing such laws. Third, the sentence is a term of lengthy incarceration in federal prison, which should be a greater deterrent than a short incarceration or probation-more common punishments in past insider trading cases.

Yet, there is no evidence to show that even white-collar offenders are influenced by the heavy penalties imposed on others. Mary Kreiner Ramirez notes that in relation to economic crime, general deterrence is difficult to measure given that most people do not make their decision to avoid illegal conduct publicly known, and hence, empirical analysis of this issue is difficult to undertake.

While there does not seem to be a link between higher penalties and less crime, it seems that people are not totally irrational when they contemplate committing crime. The evidence shows that to the extent that people make a cost–benefit decision about committing crimes, they generally only weigh up the risk of being caught, not what will happen when they are apprehended.

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236. See, e.g., John Esterhay, “Street Justice” for Corporate Fraud—Mandatory Minimums for Major White-Collar Crime, 22 Regent U. L. Rev. 135 (2009); see also Driggers, supra note 1. Earlier suggestions of the likely existence of such a link have not been established (for example, it has been suggested that there is some basis to assume the validity of this assumption). See Julie Clarke & Mirko Bagaric, The Desirability of Criminal Penalties for Breaches of Part IV of the Trade Practices Act, 31 Austl. Bus. L. Rev. 192 (2003); Donald Baker & Barbara Reeves, The Paper Label Sentences: Critiques, 86 Yale L.J. 619 (1977); Wouter Wils, Does the Effective Enforcement of Articles 81 and 82 EC Require Not Only Fines on Undertakings but also Individual Penalties, in Particular Imprisonment? 3, Paper Presented at the EU Competition Law and Policy Workshop/Proceedings, Eur. Univ. Inst. (2001).

237. Driggers, supra note 1, at 2036-37.


240. It is noted that this is contestable based on the social and fiscal psychology model, which provides that non-economic considerations are also taken into account when committing crimes. We thank the anonymous reviewer for this comment.
The National Research Council in its Report published in 2014 analyzed a large number of studies which examined the connection between harsh criminal sanctions (especially longer prison terms) and the crime rate and noted that the weight of evidence does not support the view that harsh penalties reduce crime. The Report states:

Ludwig and Raphael (2003) find no deterrent effect of enhanced sentences for gun crimes; Lee and McCrory (2009) and Hjalmarsson (2009) find no evidence that the more severe penalties that attend moving from the juvenile to the adult justice system deter offending; and Helland and Tabarrok (2007) find only a small deterrent effect of the third strike of California’s three strikes law. As a consequence, the deterrent return to increasing already long sentences is modest at best.

The conclusion that increasing already long sentences has no material deterrent effect also has implications for mandatory minimum sentencing. Mandatory minimum sentence statutes have two distinct properties. One is that they typically increase already long sentences, which we have concluded is not an effective deterrent. Second, by mandating incarceration, they also increase the certainty of imprisonment given conviction. . . . Furthermore, as discussed at length by Nagin (2013a, 2013b), all of the evidence on the deterrent effect of the certainty of punishment pertains to the deterrent effect of the certainty of apprehension, not to the certainty of postarrest outcomes (including certainty of imprisonment given conviction). Thus, there is no evidence one way or the other on the deterrent effect of the second distinguishing characteristic of mandatory minimum sentencing (Nagin, 2013a, 2013b).241

The extract above, while doubting the link between harsher penalties and less crime, suggests that there is a connection between lower crime and the perception in people’s minds that if they commit an offense they will be apprehended and subjected to some form of a criminal sanction. This is consistent with the theory of absolute general deterrence and the orthodox understanding about the considerations that reduce crime.

Accordingly, marginal general deterrence seems to be a flawed theory, while absolute general deterrence is a sound theory. The keys to reducing crime are (i) ensuring that criminal sanctions (which people would want to avoid) exist, and (ii) putting in place systems and investigative processes that will make prospective offenders believe that if they do offend there is a high chance that they will be

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241. THE GROWTH OF INCARCERATION IN THE UNITED STATES, supra note 12, at 139-40.
detected and prosecuted. The key to the first requirement is that the potential sanction does not need to be especially severe. A large fine or short prison term would suffice.

B. No Evidence that Financial Crimes Negatively Impact the Market

As we have seen, one of the main rationales for tough sentences on financial crime offenders is the damage to institutional integrity of the stock market and investor confidence. However, damage to institutional integrity is speculative. There is no evidence of a correlation between integrity of the market or investor confidence in the stock market and insider trading and market manipulation offending. If such a relationship did exist, presumably, the direct victims of such crimes would demonstrate the greatest loss of confidence in the stock market. In the United Kingdom, a scandal involving a pension-fund fraud committed by former Member of Parliament Robert Maxwell, which affected 25,000 individuals, led to a small study on the attitudinal effects of the crime on 25 of those individuals. Spalek concluded that:

The study reported in this paper illustrates that in some cases of fraud, victims may not be “duped investors”, but rather may distrust particular agents prior to any crime occurring, and may therefore be engaging in risk avoidance strategies. As a result, becoming the victim of a financial crime may not necessarily lead individuals to avoiding the financial system in general, because an integral part of their trust may be acknowledging that as investors they run risks.

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242. To this end, a number of other studies have also noted that there is a strong connection between tax evasion and a perceived low risk of detection. Many of these are summarized in James Andreoni et al., Tax Compliance, 36 J. ECON. LITERATURE 818 (1998); see also Robert Mason & Lyle D. Calvin, A Study of Admitted Income Tax Evasion, 13 LAW & SOC’Y 73, 77 (1978); Sue Yong, A Critical Evaluation of the Economic Deterrence Model on Tax Compliance, 12 N.Z. J. TAX’N L. & POL’Y 95 (2006). In particular, see the conclusions reached by Ken Devos, Measuring and Analysing Deterrence in Taxpayer Compliance Research, 10 J. AUSTL. TAX’N 182 (2007). Devos also notes that the complexity of taxation law may also be relevant to the level of compliance; although, its precise effect is not clear. Id. The same situation should apply to all white-collar offenses.


244. Id.
The absence of a correlation between financial crimes and trust in the political and economic arenas is supported by research conducted elsewhere.245

To further test the proposition that there is a link between market confidence and market offenses, we now examine the behavior of the market following a high-profile sentence for a relevant crime. For each of the above thirty-six crimes, we look at the behavior of the share market on the day of the sentence for the crime, the day after the for the sentence crime, and a week after the sentence for the crime.

First, it is important to give some background for the methodology relating to the selection of cases and the relevant time periods. The above cases were chosen because they received the highest penalties for cases of their type in the respective jurisdictions. It is assumed that, given that these cases involved the highest penalties, they would have attracted a considerable degree of publicity and hence become known to much of the investor community.

We focus only on cases since the year 2000, given that it was approximately around this time the Internet had become commonplace246 and there was ample capacity to widely and instantly impart information relating to events, including sentences for serious criminal offenses. In terms of modeling trends in the fluctuation of the stock market, we consider three time periods. The first is the day of the case.247 The second is the business day after the sentence was imposed. The third reference point is a week after the sentence was imposed for the offense. We selected these time periods because the information about the sentence would be most prominent at the time of the sentence. Presumably the decisions, judgments, and behavior of investors and potential investors would be most considerably impacted when the details of the sentence and

245. The general conclusion in these studies is that white-collar crimes have little, if any, effect on trust. See, e.g., John G. Peters & Susan Welch, The Effects of Charges of Corruption on Voting Behavior in Congressional Elections, 74 AM. POL. SCI. REV. 697 (1980); Michael Mills & Elizabeth Moore, The Neglected Victims and Unexamined Costs of White-Collar Crime, 36 CRIME & DELINQ. 408 (1990); Neal Shover et al., Long-Term Consequences of Victimization by White-Collar Crime, 11 JUST. Q. 75 (1994).


247. Sentences are typically handed down early in the day, and hence, there is ample opportunity for news of the sentencing to impact trading on the stock market, which continues until 4:00 p.m. each business day.
the crime were most widely disseminated. The value of the respective stock markets was not analyzed more than a week after sentence because, presumably, by this time the impact of a sentence would have diluted considerably.

Most importantly, the cases we consider were not influenced by any pre-existing sentiment regarding stock market movements at around the time of the sentence. The analysis relating to stock market movement only commenced after the cases were identified.

As we have seen, the concept of the “integrity of the market” is commonly used, but it has not been defined with any degree of detail. The term is commonly associated with the need to maintain investor confidence in the stock market, and hence, it presumably relates to maintaining conditions that give investors and prospective investors assuredness that the market is transparent and operates with a degree of probity. There is no direct test that can be developed to test the impact that market crime has on the sentiment of investors and prospective investors. As a proxy for this, we use the value of the stock market. If stock market crime did reduce confidence in the stock market, this would presumably result in investors and potential investors reducing their involvement in the market. The effect of this would reduce the total value of the stock market. In short, we assume that reduced confidence in the share market would result in a fall in the value of the price of securities listed on the stock market.

In relation to the United States Stock Exchange, the main measure of the value of the share price is the Dow Jones Industrial Average (“DJIA”), which shows how 30 significant U.S. listed companies, including General Electric and Walt Disney, traded during a standard trading session in the stock market.248 In Australia, there are two major stock market indices. The first is the All Ordinaries (XAO) or “All Ords,” which gives an indication of security trading for the Australian stock market and contains the 500 largest ASX listed companies by way of market capitalization.249 The second is the S&P/ASX 200 (XJO) Index, which is the share market index for gauging security trading of the top 200 ASX listed companies by way of float-adjusted market capitalization.250 These


two track very closely in terms of value. Even though the ASX is now the major index adopted in Australia, we use the All Ordinaries because this was the official Index in 2000—when our case analysis commenced.

The methodology that we employ to test whether stock market crime impacts share price is admittedly crude. There are almost an infinite range of matters that drive investor behavior on the share market, including employment data, inflation figures, natural disasters, the balance of the terms of trade, and company performance data. In order to ascertain the impact of financial market crime on the confidence of investors, it would be necessary to hold all variables constant, with the only change being widespread reporting of a major stock market crime. This is impossible given that no two days are the same regarding the diversity of the economic and other data that emerges on any given day.

Thus, the analysis below is subject to these considerable caveats. However, the analysis is important because the existing assumption is that financial market crime reduces investor confidence in the market. If this assumption is valid it needs to be demonstrated—otherwise financial market criminals are having their sentences increased simply on the basis of a judicial hunch. In order to give some legitimacy to this assumption, some evidence is necessary to show a connection between a reduction in investor confidence and financial market crime. The most telling and obvious demonstration of this connection would be to show that the share market goes into decline when reportage of major stock market crime occurs. Of course even such data would not be conclusive because it may well be that any such falls are due to other events, but nevertheless, some plausibility would be conferred to that theory.

We now set out the data regarding movements in the share market price at the relevant time points for each of the cases set out above.
### United States—Insider Trading Cases

<table>
<thead>
<tr>
<th>Case Name and Date of Sentence</th>
<th>DJIA Start of Day of Sentence</th>
<th>DJIA End of Day of Sentence</th>
<th>DJIA Day after Sentence</th>
<th>DJIA Week after Sentence</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. <em>U.S. v. Goffer</em>, 721 F.3d 113 (2d Cir. 2013) (July 1, 2013)</td>
<td>14,911.60</td>
<td>14,974.96</td>
<td>14,932.41</td>
<td>15,224.69</td>
</tr>
<tr>
<td>4. <em>U.S. v. Bauer</em>, 529 F. App’x 275 (3d Cir. 2013) (June 27, 2013)</td>
<td>14,921.28</td>
<td>15,024.49</td>
<td>14,909.60</td>
<td>15,135.84</td>
</tr>
<tr>
<td></td>
<td>Case Reference</td>
<td>Share Market Values</td>
<td></td>
<td></td>
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<tr>
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<td>-------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------</td>
<td></td>
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</tr>
<tr>
<td>7</td>
<td><em>U.S. v. Nacchio</em>, 573 F.3d 1062 (10th Cir. 2009) (July 31, 2009)</td>
<td>9,154.61 9,171.61 9,286.56 9,370.07</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td><em>U.S. v. Royer</em>, 549 F.3d 886 (2d Cir. 2008) (Dec. 17, 2008)</td>
<td>8,921.91 8,824.34 8,604.99 8,468.48</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td><em>U.S. v. Waksal</em>, No. 02-cr-01041-WHP-1 (S.D.N.Y. June, 10, 2003) (June 10, 2003)</td>
<td>8,980.79 9,054.89 9,183.22 9,323.02</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The above data is illuminating. It shows, more often than not, the share market does not fall in the immediate vicinity of a major insider trading offense. In six of ten cases, the share market in fact rose on the day of the sentence. If one compares the value of the share market on the day of the sentence to the close the day after, we see that the share market still rose in five of the cases. And a week after the sentence, the market had increased in seven out of ten
instances. Thus, of the thirty events, we see that overall the share market in fact rose on eighteen of these occasions.

**Australia—Insider Trading Cases**

<table>
<thead>
<tr>
<th>Case Name and Date of Sentence</th>
<th>All Ordinaries Start of Day of Sentence</th>
<th>All Ordinaries End of Day of Sentence</th>
<th>All Ordinaries Day after Sentence</th>
<th>All Ordinaries Week after Sentence</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. <em>Cth DPP v Christopher Russell Hill</em> [2015] VSC 86 (Austl.) (Mar. 17, 2015)</td>
<td>5,769.70</td>
<td>5,811.00</td>
<td>5,808.00</td>
<td>5,934.50</td>
</tr>
<tr>
<td>3. <em>R v ZHU, Bo Shi</em> [2013] NSWSC 127 (Austl.) (Feb. 15, 2013)</td>
<td>5,052.70</td>
<td>5,054.60</td>
<td>5,082.90</td>
<td>5,036.70</td>
</tr>
<tr>
<td>7. <em>R v Rivkin</em> [2003] NSWSC 447 (Austl.) (May 29, 2003)</td>
<td>2,976.10</td>
<td>2,983.60</td>
<td>2,979.80</td>
<td>3,008.00</td>
</tr>
</tbody>
</table>
The above data shows that more often than not, the share market does not fall in the immediate vicinity of a major insider trading offense. In five of the eight cases, the share market rose on the day of the sentence. If one compares the value of the share market on the day of the sentence to the close the day after, we see that that share market rose in four of eight cases, but a week after the day of the sentence this had increased to six out of eight cases. Thus, of the twenty-four events, we see that overall the share market in fact rose on fifteen of these occasions.

**United States—Market Manipulation Cases**

<table>
<thead>
<tr>
<th>Case Name and Date of Sentence</th>
<th>DJIA Start of Day of Sentence</th>
<th>DJIA End of Day of Sentence</th>
<th>DJIA Day after Sentence</th>
<th>DJIA Week after Sentence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <em>U.S. v. Hawatmeh</em> [Unreported, U.S. District Court in Tacoma] (June 5, 2015)</td>
<td>17,905.38</td>
<td>17,849.46</td>
<td>17,766.55</td>
<td>17,898.84</td>
</tr>
<tr>
<td>2. <em>U.S. v. Madoff</em>, No. 09 Cr. 213 (DC), 2009 WL 8681361 (June 29, 2009)</td>
<td>8,440.13</td>
<td>8,529.38</td>
<td>8,447.00</td>
<td>8,324.87</td>
</tr>
<tr>
<td>5.</td>
<td>U.S. v. Scrushy [Unreported, U.S. District Court, M.D. Ala.] (June 28, 2007)</td>
<td>13,427.48</td>
<td>13,422.28</td>
<td>13,408.62</td>
</tr>
<tr>
<td>8.</td>
<td>U.S. v. Ebbers, 458 F.3d 110 (2d Cir. 2006 (July 13, 2005)</td>
<td>10,513.36</td>
<td>10,557.39</td>
<td>10,628.89</td>
</tr>
<tr>
<td>9.</td>
<td>U.S. v. Rigas, No. 02 Cr. 1236 (LBS), 2008 WL 2544654 (S.D.N.Y. June 24, 2008) (June 20, 2005)</td>
<td>10,621.54</td>
<td>10,609.11</td>
<td>10,599.67</td>
</tr>
</tbody>
</table>
Halting the War on White-Collar Offenders


<table>
<thead>
<tr>
<th>Case Name and Date of Sentence</th>
<th>All Ordinaries Start of Day of Sentence</th>
<th>All Ordinaries End of Day of Sentence</th>
<th>All Ordinaries Day after Sentence</th>
<th>All Ordinaries Week after Sentence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <em>Nigel Derek Heath v R</em> [2016] NSWCCA 24 (Austl.) (Feb. 25, 2016)</td>
<td>4,943.30</td>
<td>4,944.70</td>
<td>4,945.10</td>
<td>5,083.50</td>
</tr>
</tbody>
</table>

The above data shows that in three of the ten instances, the share market rose on the day of the sentence and this increased to five instances if one compares the value of the share market on the morning of the sentence to the close the day after. This then fell back to three out of ten if one compares the value of stock market a week after the morning of the sentence. Thus, of the thirty events, we see that overall the share market in fact rose on eleven of these occasions.

**Australia—Market Manipulation cases**
The above data shows that in two of the seven instances, the share market rose on the day of the sentence but this increased to five out of seven if one compares the value of the share market on the opening of the day of the sentence to the close the day after. This then fell back to two out seven if one compares the value of stock market a week after the morning of the sentence. Thus, of the twenty-one events, we see that overall the share market rose on nine of these occasions.
If one adds all the 105 events, we see that the market rose on fifty-six of these occasions, or on 53% of the occasions. On any given day, the market can obviously increase, decrease, or remain the same. During the period 2000 to 2015, both the Dow Jones and All Ordinaries increased. Thus, one would expect that there would be more days and weeks where the respective indices increased as opposed to decreased. There is no readily accessible data on this apart from a chart that notes the number of days that the Dow Jones increased as opposed to decreased during the period 2000 to 2015. This shows that from 2000 to 2015, the Dow Jones increased on 53% of trading days. Interestingly, this is identical to the percentage of days and weeks described above in which the stock market indices rose around the time of sentencing for major stock market offending. Thus, on the basis of the above data, the most tenable conclusion is that stock market offenses have no impact on the integrity of the markets or the level of confidence that investors have in the market.

As noted above, this data is not definitive of the impact that such crime has on the market. However, it is supportive of the conclusion that there is no negative link between stock market crime and investor confidence. It is even more supportive of the conclusion that there is not a strong link between these two events. If the link regarding these two events was strong, presumably it could operate to negate at least some otherwise positive sentiment stemming from other favorable economic news that may have emerged on a relevant trading day. The most important observation to emerge from the above analysis is that an examination of stock market movements in the period shortly after sentences have been handed down in major stock market crime provides no support for the theory that major financial crime undermines the integrity of the market or investor confidence. It follows that unless positive evidence is shown to the contrary, this consideration cannot any longer be used to justify harsher terms for criminals who commit stock market offenses.

251. There are thirty-five cases above and share market movements for each case are tracked for three relevant days.
252. On January 1, 2000 the Dow Jones was 11,357.51 and this rose to 17,425.03 on December 31, 2015. During the same period, all the Ordinaries increased from 3,124.10 to 5,344.60.
254. This follows from the view that aggravating factors must be established beyond reasonable doubt. Anderson v The Queen (1993) 177 CLR 520, 536; R v Olbrich (1999) 199 CLR 270 (Austl.).
It is important to emphasize that the sample size of cases above is relatively small and, given the multitude of other factors that influence stock market moves, the conclusions we have reached about the impact of market offenses on the stock market are necessarily tentative. However, what is certain is that there are a large number of variables that impact share market price and that individuals have a strong desire to increase their wealth and to derive passive income, such as in the form of stocks. The value of the total shares listed on the Dow Jones and All Ordinaries is many trillions of dollars. Moreover, there is a massive financial services industry that has been established with the singular goal of investing in the share market with a view to increasing financial wealth. In order to do this, stock brokers and traders and the broader securities and financial industry are highly motivated to develop tools and algorithms that anticipate the likely movement of the market.

There are a large number of such tools in existence. Crucially, no market predictive model incorporates market crime into the variables it uses regarding the likely movements in the market. This is because market experts are aware that stock market offenses have no impact on investor confidence. Alternatively, all of the experts are wrong and the courts are correct that market offenses undermine investor confidence. The markets are driven by empirical data. The courts are not, and thus, the first hypothesis is preferable.

An obvious counter to this analysis is that stock market offending is relevant to investor confidence and that the sentencing of offenders for these offenses in fact increases or at least maintains confidence because it shows that such crimes are detected and dealt with sternly. Thus, the contention is that news of stock market offending in fact firms up investor confidence as opposed to diminishes it precisely because the sentences that are imposed are typically stern. To fully test this proposition, we would need to compare stock market movements in cases where offenders were dealt with by way of very lenient sentences (and preferably by means of a tokenistic sentence) to when the same offenders were given the same sentences as above in circumstances where all other factors that could influence the market were held constant. This is obviously

impossible. However, in our view the counter is not persuasive for several reasons. First, as we have seen above, the imposition of harsh sentences on market manipulators does not seem to increase or decrease market confidence. It appears to have no impact whatsoever on the price of stocks. Secondly, if news of market crime is to have a meaningful impact on investor confidence, the greatest indicator of criminal activity in this area is a finding of guilt (which is a precondition to the imposition of a sentence) for a market manipulation offense; hence, this event is likely to adversely impact, as opposed to having a positive impact, irrespective of what penalty is imposed. The fact that harsh penalties are imposed on offenders does not seem to negate the negative impact that can flow from the incidence of crime.\(^\text{256}\) The most likely scenario is that investors and potential investors in stocks are aware that all investing has a level of risk, including the risk of inappropriate trading, and factor this into their investment decisions. The best manner to preserve confidence in the market is to implement systems such that investors and potential investors believe that people who attempt to cheat the market are detected and prosecuted—the sternness of the ultimate penalty is largely irrelevant.

Given that general deterrence is a flawed sentencing objective and that financial market offenses do not undermine the market, the main considerations in favor of harsh penalties for this cohort of white-collar offenders are flawed. It follows that a different, more lenient approach should be taken towards sentencing market manipulators and insider trading offenders. In developing this approach, the key determinant regarding the severity of an appropriate sanction is the principle of proportionality. It is to this that we now turn.

\(^{256}\) See, e.g., Alyssa Davis, *In U.S., Concern About Crime Climbs to 15-Year High*, GALLUP (Apr. 6, 2016), http://www.gallup.com/poll/190475/americans-concern-crime-climbs-year-high.aspx [https://perma.cc/272N-CMDD]. This report shows that fear of serious crime is increasing perhaps due to increased media report of crime and a slight increase in the rate of crime. The fact that harsh penalties are imposed on culprits of serious crime does not seem to negate this fear.
IV. PROPORTIONALITY—THE KEY DETERMINANT

A. Financial Crime Is Less Damaging than Sexual and Violent Crimes

In its simplest and most persuasive form, the proportionality principle is the view that the punishment should fit the crime. The principle of proportionality (at least in theory) operates to “restrain excessive, arbitrary and capricious punishment” by requiring that punishment must not exceed the gravity of the offense, even in order to extend a period of imprisonment in order to further protect the community from the offender.

As the High Court of Australia stated in *Hoare v The Queen*, "a basic principle of sentencing law is that a sentence of imprisonment imposed by a court should never exceed that which can be justified as appropriate or proportionate to the gravity of the crime considered in the light of its objective circumstances." Proportionality is a requirement of the sentencing regimes of ten states in the United States. The precise considerations, which inform the proportionality principle, vary in those jurisdictions, but generally there are six relevant criteria:

1. Whether the penalty shocks a reasonable sense of decency;
2. The gravity of the crime;
3. The prior criminal history of the offender;
4. The legislative objective relating to the sanction;
5. A comparison of the sanction imposed on the accused with the penalty that would be imposed in other jurisdictions; and


261. *Id.* at 354.

(6) A comparison of the sanction with other penalties for similar and related offenses in the same jurisdiction.263

In addition to this, a survey of state sentencing law by Thomas Sullivan and Richard Frase shows that at least nine states have constitutional provisions relating to prohibiting “excessive penalties or treatment,”264 and twenty-two states have constitutional clauses that “prohibit cruel and unusual penalties, including eight states with a proportionate-penalty clause.”265

Broken down to its core features, proportionality has two limbs. The first is the seriousness of the crime and the second is the harshness of the sanction. Further, the principle has a quantitative component—the two limbs must be matched. For the principle to be satisfied, the seriousness of the crime must be equal to the harshness of the penalty.266

Some commentators have argued that proportionality is so vague as to be meaningless, in light of the fact that there is no stable and clear manner in which the punishment can be matched to the crime. Jesper Ryberg notes that one of the key and damaging criticisms of proportionality is that it “presupposes something which is not there, namely, some objective measure of appropriateness between crime and punishment.”267 The most obscure and unsatisfactory aspect of proportionality is that there is no stable and clear manner in which the punishment can be matched to the crime. Jesper Ryberg further notes that to give content to the theory, it is necessary to rank crimes, rank punishments, and anchor the scales.268

There is some merit in Ryberg’s critique. While doctrinally it has been argued that there is a manner in which firmer content could be accorded to the proportionality doctrine,269 an exact matching of

263. Id. at 250.
265. Id. at 154.
266. Fox, supra note 258, at 491.
268. Id. at 185. Even retributivists have been unable to invoke the proportionality principle in a manner that provides firm guidance regarding appropriate sentencing ranges. See, e.g., Andrew Von Hirsch & Andrew Ashworth, Proportionate Sentencing 122 (2005).
269. Mirko Bagaric, Injecting Content into the Mirage that is Proportionality in Sentencing, supra note 257, at 440.
offense severity and penalty harshness is not feasible in light of the current understanding of proportionalism.

However, this is not an issue that needs to be settled and resolved for current purposes. Irrespective of the precise manner in which harmfulness is assessed, it is clear that a cardinal criterion is the extent to which it sets back the interests and welfare of victims. Accordingly, homicide offenses are the most serious crimes. This is followed by other crimes against the person. Studies show victims of violent crime and sexual crime have their well-being more significantly set back than for other types of crime. For example, a review of the existing literature regarding the effects of violent and sexual crimes on key quality of life indices by Rochelle Hanson, Genelle Sawyer, Angela Begle, and Grace Hubel demonstrated that many victims suffered considerably across a range of well-being indicia, well after the physical signs had passed. The report concluded:

In sum, findings from the well-established literature on general trauma and the emerging research on crime victimization indicate significant functional impact on the quality of life for victims. However, more research is necessary to understand the mechanisms of these relationships and differences among types of crime victimization, gender, and racial/ethnic groups.

In another study examining the effects of either violent or property crime on the health of 2,430 respondents, Chester L. Britt noted, “[V]ictims of violent crime reported lower levels of perceived health and physical well being, controlling for measures of injury and for sociodemographic characteristics.” Further, these findings were not confined to violent crime: Victims of property crime also reported reduced levels of perceived well-being, but it was less profound than in the case of violent crime.

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270. Id. at 413.
272. Rochelle Hanson et al., The Impact of Crime Victimization on Quality of Life, 23 J. Traumatic Stress 189, 189 (2010).
273. Id. at 194.
274. Id. at 194-95.
275. Britt, supra note 271, at 63.
276. Id.
Property offenses set back the interests of victims, but they recover quicker than victims of sexual and violent offenses. To the extent that property offenses damage victims, relevant considerations include the value of the crime and financial means of the victim. Thus, crimes committed against individuals, especially those who are financially vulnerable or fragile (i.e., the poor and unemployed) cause more direct and much greater harm than crimes\textsuperscript{278} committed against the wealthy individuals or large corporations. Another important consideration is the nature of the victim. Individual people have actual interests, projects, and feelings. Institutions do not. They are inanimate. They have no feelings, preferences, or desires. The only hurt that is felt by them is completely derivative upon harm caused to individuals involved in the markets. Thus, crimes that damage confidence in the market are potentially harmful. However, as we have seen, this does not seem to be the case in relation to white-collar crimes in the form of insider trading and market manipulation offenses.

Thus, relatively speaking, property offenses are at the lower end of the harm spectrum so far as proportionality is concerned, and within the category of property offenses, crimes against financial market offenses are the least serious.\textsuperscript{279} Imprisoning these offenders violates a fundamental tenet stemming from the proportionality principle, which is that the most serious forms of sanctions should be reserved for the most damaging forms of crime.

B. Illustration of Appropriate Penalties for Market Cheats

Market cheats often benefit considerably from their crimes. This seems to generate an impulse to punish them severely. However, as we have seen, beyond this unreflective instinct there is no rational basis for imprisoning offenders who commit insider trading and market manipulation offenses for long periods. Long prison terms do not deter the commission of similar offenses. They do not undermine the integrity of markets. Financial market offenses are low on the scale of harm-occasioning crimes. They do not mandate the imposition of the harshest criminal sanctions, especially for long durations. Moreover, long prison terms for market cheats are self-defeating from the community perspective because they result in

\textsuperscript{278} This is often already reflected in existing practice. \textit{See} Driggers, \textit{supra} note 1, at 2037.

\textsuperscript{279} \textit{See, e.g.}, Britt, \textit{supra} note 271.
the community inflicting considerable suffering on itself by directing precious resources to prisons and hence redirecting the resources from incontestable community benefit in the form of education and health.

As a society, we need to become clever and more effective regarding community expenditure. There is nothing positive that can be achieved by a ten-year term of imprisonment for an insider trader or market manipulator that cannot be achieved by a less harsh sanction. A progressive, empirically informed, and morally sound sentencing approach to insider trading and market manipulation offenses entails that the maximum penalty for such offenses would be one year imprisonment, and a typical penalty in the order of six months, which in most instances could be substituted with another sanction—in particular, electronic monitoring.²⁸⁰

Further, in most circumstances, a short prison term should be substituted for a period of electronic monitoring of approximately double the length of the prison term. There are other ways to limit the liberty of offenders beyond confining them behind high walls. Financial market cheats do not scare society and have not shown an inclination to engage in violent conduct, and hence, there is no demonstrated need to contain them behind concrete walls to protect the community from acts that can seriously harm individuals. The advantage of electronic monitoring is that it can confine offenders at a fraction of the cost of imprisonment.²⁸¹

Electronic monitoring, which originated in the United States in the early 1980s, is now used in a number of countries, including the United Kingdom.²⁸² There are now over 100,000 people under electronic monitoring in the United States.²⁸³

²⁸². See Nellis, supra note 280, at 41.
Electronic monitoring works by attaching a transmitting object on the person of the offender that is designed to communicate signals to authorities. Electronic monitoring can be via radio devices or GPS. In relation to GPS, the subject is monitored 24/7 by satellites receiving transmitted information that is then triangulated to provide data on location and movement. When the subject enters a forbidden territory or leaves a geographic limit, the surveillance officers are alerted via an alarm, which is also sent to the offender. If the offender does not take corrective action, the authorities can order intervention in order to bring him into conformity.

The main advantage of electronic monitoring is that the process costs far less than imprisonment. The potential for cost savings ranges from six to ten times when compared to the alternatives. Another considerable advantage of electronic monitoring is that studies indicate that active electronic monitoring reduces recidivism. For example, a study of recidivism rates of Argentinian offenders comparing those who had been jailed versus those who had been tagged showed that the former’s recidivism rate was 22% compared to 13% for the latter.

284. See Payne, supra note 283, at 382.


Despite this, there has been a decline in the use of electronic monitoring in the United States. As noted by Lars H. Andersen and Signe H. Andersen, there are three main reasons for this:

First, the money saved on imprisonment thanks to the use of electronic monitoring was now spent on testing and supervising the electronically monitored people (e.g., alcohol tests). Second, electronic monitoring and other noncustodial alternatives to imprisonment tended to widen the punitive system by putting more people under the purview of the criminal justice system. Third, the more intensive testing and supervision increased detection rates for recidivism and technical violations, which in turn sent even more people into custody. This led some policy makers to view electronic monitoring and other noncustodial alternatives to imprisonment as failed social experiments, and the popularity of these programs faded in the United States.288

None of these potential issues apply to financial markets so long as they are only subject to electronic monitoring in circumstances where they would have otherwise been sentenced to a term of prison—thus there is no prospect of making offenders from this cohort subject to the purview of the prison system.

The main emphasis of this Article has been on market offenders. However, the conclusions have several notable implications for white-collar offenses more generally. The main rationale for punishing white-collar offenders heavily is general deterrence, which, as we have seen, is flawed. Once this driver is removed from the white-collar sentencing calculus, the case for harsh treatment is significantly weakened. It is less weakened in situations where the victim is an identifiable individual, yet, as we have seen, financial loss to a victim is far less damaging than a violation of their physical or sexual integrity. It follows that even white-collar offenses committed against individuals should be treated considerably more leniently. As a general rule, offenders guilty of white-collar offenses which cause harm to individuals should not be sentenced to terms of imprisonment beyond two years.

CONCLUSION

Insider trading and market manipulation offenses can generate considerable gains to offenders. Understandably, there is a strong desire to punish these offenders. However, the punitive impulse must be moderated and informed by the attainable objectives of sentencing

288. Andersen & Andersen, supra note 283, at 351.
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and normative constraints regarding the appropriate amount of punishment.

Insider trading and market manipulation offenses frequently result in offenders being sentenced to imprisonment—often for years, and in some instances, decades. The penalties for such offenses are increasing. This approach is empirically and normatively unsound.

The main sentencing rationale that is invoked for imposing stern sanctions on these market cheats is the need to supposedly deter other offenders from committing similar crimes. From the common-sense perspective, this aim is feasible, and in fact sensible. But it is contradicted by the empirical studies. There is no evidence that prospective white-collar offenders are discouraged from committing the crime by the prospect of harsh penalties if they are detected and successfully prosecuted. Accordingly, the objective of general deterrence cannot justify severe penalties for such offenders.

Orthodox sentencing methodology suggests that another key reason for imposing harsh sentences on insider traders and market manipulators is that their crimes damage confidence in the markets and the integrity of the market system. This claim is always made without proof. In this Article, the claim was tested. Our comparison of stock market moves shortly after sentences for major stock market crime provides no support for this claim. In fact, our study is suggestive of the contrary hypothesis. In the period shortly after a sentence is handed down for a major stock market offense, the value of the market more commonly goes up rather than down.

Moreover, crimes committed by insider traders and market manipulators do not normally harm people in a meaningful fashion. Insider trading and market manipulation offenses can result in an unfair gain to the offender, but this does not necessarily translate to a loss to another individual. And if such a loss was perceptible, the evidence suggests that victims of financial crime recover from such offenses far more readily than sexual and violent crime victims. Financial crime is bad, but not as a damaging as sexual and violent offenses. The default position is that the most severe forms of punishment should be reserved for the most severe crimes. This approach repudiates current sentencing patterns for insider trading and market manipulation offenders.

There is not a single community benefit that will be secured by sending insider traders and market manipulators to lengthy terms of imprisonment. The maximum prison term for such offenders should be no more than imprisonment for one year, and in most cases this
should be substituted for a period of electronic monitoring of two years. White-collar offenders who harm target individuals should be dealt with more severely. Yet, the harm they cause is not as significant as that approaching the most serious form of criminal offending in the form of serious sexual and violent crime, and hence the maximum terms for even these offenders should be greatly reduced—to no more than two years’ imprisonment.

The recommendations proposed in this Article would provide proportionate sentences for white-collar criminals, and would result in a reduction in incarceration levels, saving the community large amounts of taxpayer dollars. In turn, the amount saved could be directed into positive government programs such as education and health. Most of all, there would not be any offsetting disadvantages. The benefits would still be greater if an empirically based approach to sentencing was applied to all offense categories.