IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA	
v.	**CRIMINAL NO. 08-CR-371 (PLF)**
STEWART D. NOZETTE	
Defendant.	

DEFENDANT STEWART D. NOZETTE'S SENTENCING MEMORANDUM

Bradford A. Berenson
D.C. Bar No. 441981
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, D.C. 20005
Telephone: (202) 736-8000
Fax: (202) 736-8711
Email: bberenson@sidley.com

TABLE OF CONTENTS

INTRODUCTION

Dr. Stewart Nozette is a research scientist who specializes in the design of satellites and space-based instruments for lunar exploration. He holds a Ph.D in Planetary Science from the Massachusetts Institute of Technology, has served on the White House National Space Council, and has been a central player in the international effort to explore polar regions of the moon's surface. A satellite he designed hangs on public display at the Smithsonian Air and Space Museum on the National Mall.

Dr. Nozette comes before the Court for sentencing having pled guilty in this case to one count of conspiracy to defraud the United States through the submission of false claims, and one related count of tax evasion. These two offenses arise from a single course of conduct involving misadministration of a peculiar form of government contract known as an Intergovernmental Personnel Act ("IPA") agreement. That conduct involved using IPA funds received by a small 501(c)(3) organization Dr. Nozette owned and controlled, the Alliance for Competitive Technology ("ACT"), to defray personal expenses that were incorrectly characterized on invoices as fringe benefits paid to him by ACT. These expenses were not eligible for reimbursement under the IPA, thus resulting in the false claims to the contracting agencies, and they should have been paid for out of personal funds Dr. Nozette otherwise would have received as salary from ACT, thus resulting in tax evasion. Dr. Nozette has accepted responsibility for this conduct, pled guilty, paid his tax liability, and worked to make amends by assisting the government in other investigations.

We are of course mindful that, in September 2011, Dr. Nozette pled guilty to charges of attempted espionage for conduct post-dating his plea in this case. Dr. Nozette's 11(c)(1)(C) plea agreement in that case, which this Court accepted at the plea hearing on September 7, 2011, imposes an incarceration term of 156 months, far longer than any possible term of imprisonment

he faces on the charges in this case. And because the plea agreement in the attempted espionage case also provides that Dr. Nozette will serve his sentences on both set of charges concurrently, it is unlikely that the term of incarceration imposed by the Court in this case will have any ultimate impact on the time Dr. Nozette actually serves. Nonetheless, out of an abundance of caution and to protect the record, we make a full sentencing presentation in this submission, and urge upon the Court what we believe to be a just and appropriate sentence for the offenses at issue here.[1]

Dr. Nozette respectfully requests that this Court depart downward from the Sentencing Guidelines and show him maximum leniency with respect to incarceration on the charges in this case. He further requests that restitution be ordered in the amount of $62,593.01, to be paid in periodic nominal payments after his incarceration ends, and that no additional fines be imposed.

No purpose would be served by imposing a significant term of imprisonment for Dr. Nozette on the false claims and tax charges: quite apart from the longer, concurrent sentence to be imposed in the attempted espionage case, before these charges were leveled at him, Dr. Nozette had no criminal history; he poses no threat of recidivism; he has rare and important scientific expertise that has been and continues to be used for the benefit of society; and he has played an important part in the care and support of his ex-wife, Wendy, who has been battling metastatic breast cancer. He has already suffered greatly for his offense, facing the loss of his reputation, the most important source of his most rewarding work, and essentially all of his personal resources through the costs and forfeitures arising from the two cases against him. The process of defending himself against the attempted espionage charges on which he will also be sentenced — charges based on conduct that essentially grew out of Dr. Nozette's frustration over this case — has imposed even higher financial and emotional costs.

[1] Dr. Nozette's sentencing was delayed since he pled guilty to charges of attempted espionage so that he could provide additional cooperation to government agents and be sentenced simultaneously in both pending cases.

Moreover, his offense conduct, while serious, was born of corner-cutting cupidity rather than true wickedness: as explained in greater depth below, despite the mischaracterization of certain expenses as fringe benefits, ACT and Dr. Nozette performed all the work they promised to perform under the IPA agreement and succeeded in their mission for the government, and that work did not cost the contracting agencies a dollar more than they had committed to spend. Although Dr. Nozette understands and accepts that what he did was wrong, he felt at the time that his behavior caused no real harm, given the fair value received by the government, the ambiguous cost accounting rules and practices associated with IPA arrangements, and indications he received from government contracting officials that IPAs were treated by the government essentially as fixed-cost grants, rather than variable-cost contracts.

In light of these factors, Dr. Nozette felt frustrated by the investigative and prosecutorial effort directed at him after years of faithful and fruitful service to the United States. Indeed, it was this frustration that rendered him susceptible to the government's sting operation that resulted in the attempted espionage charges. Yet despite his high level of frustration over these charges, when called to account, Dr. Nozette promptly recognized he had done wrong and accepted responsibility for his actions. He pled guilty and spared the government the burden and expense of trial, even though he had a triable case. He aided the government in its investigation of this matter, meeting with the United States Attorney's office, government agents, and IRS personnel numerous times. And he provided substantial assistance to the government's efforts to investigate suspected misconduct by others, even agreeing, at some personal risk to himself, to work undercover and surreptitiously record communications with other individuals.

For all of these reasons, Dr. Nozette deserves lenient treatment by the Court.

BACKGROUND

Dr. Stewart Nozette. Stewart Nozette was born in Chicago, Illinois on May 20, 1957. He is 54 years old, was married to Ms. Wendy McColough from 1993 until recently, and has a 28 year-old step-son. Dr. Nozette has no criminal history. *See* Presentence Investigation Report ("PSR") at 8. Dr. Nozette received his Bachelor's of Science degree in Geosciences from the University of Arizona in 1979 and his doctorate in 1983 when he graduated from the Massachusetts Institute of Technology with a Ph.D in Planetary Sciences. He went on to be a post-graduate researcher with the California Space Institute at the University of California, and in 1984, began serving as an adjunct professor in the Department of Aerospace Engineering and Engineering Mechanics at the University of Texas at Austin. In both those positions, Dr. Nozette conducted sponsored research for NASA.

From 1989-1990, Dr. Nozette was a staff member of the President's National Space Council, and from 1990-1991, he was a staff member of the Synthesis Group, a Presidential Commission chartered to plan the Space Exploration Initiative, led by Apollo Astronaut Thomas P. Stafford. Dr. Nozette then became the Deputy Program Manager and Chief Scientist of the Clementine Program, which was part of the Strategic Defense Initiative Organization (later renamed the Ballistic Missile Defense Organization) under the Office of the Secretary of Defense. Clementine was the first United States mission to the moon since 1972. For his participation in this program, Dr. Nozette received numerous awards, including the NASA Exceptional Achievement Medal, a National Space Society Young Space Pioneer Award, and a National Space Society Engineering Award. Clementine, which is Dr. Nozette's design, hangs in the Smithsonian's National Air and Space Museum in Washington, DC. *See* Ex. A. From 1994-1997, Dr. Nozette was assigned to the United States Air Force via an IPA agreement and

was charged with initiating and directing a congressionally funded microsatellite technology program — Clementine 2.

Since then, Dr. Nozette has held a number of research positions focused on designing, launching, and steering moon-orbiting satellites that search for lunar ice. On May 8, 2008, Dr. Nozette received a NASA Group Achievement Award for his significant contributions to the successful delivery of the Mini-Radio Frequency ("Mini-RF") payloads on the Chandrayaan-1 and Lunar Reconnaissance Orbiter ("LRO") missions (collectively, "the Mini-RF project"). These two satellites orbited the moon collecting data during the summer of 2009, and Dr. Nozette worked closely with the space agency of India to accomplish this. *See* "Two Satellites Work Together in Search for Lunar Ice," *Aerospace Daily and Defense Report*, August 21, 2009 (Ex. B). The data gathered by the two satellites provides the best evidence yet that frozen water exists at the polar surfaces of the moon, a successful scientific discovery that will long outlive Dr. Nozette. Much of the work related to this extraordinary mission was performed pursuant to the IPA agreements at issue in this case.

In addition to these public achievements, Dr. Nozette has had others of equal or greater significance that cannot be discussed in a public filing. For more than twenty-five years, Dr. Nozette has held high-level security clearances with various government agencies, and he has worked on vital national security projects involving nuclear and space-based defense technologies. He has been trusted with, protected, and sometimes created the country's most sensitive national defense secrets for decades. Although recently convicted of having betrayed that trust for the intended benefit of an allied nation, that conviction stemmed from his frustration with what he perceived to be the government's unduly harsh handling of this case.

Of course, Dr. Nozette was angry at himself — and depressed to the point of having suicidal intentions — for the way in which his mishandling of the IPA agreements had left him vulnerable to bureaucratic reprisals, but he was equally upset at what he believed to be the unreasonable and overly aggressive treatment of what were in fact relatively minor offenses arising from bona fide and valuable service he had rendered to the government. When the government then designed an operation (in the very midst of his cooperation in this case) designed to tempt him into far more serious misconduct, his frustration and disappointment rendered him susceptible to the undercover agent's advances, leading to another mistake that will cost him far more than his offense in this case ever could have. There is no indication, however, that Dr. Nozette would ever have taken affirmative steps to engage in espionage-related activities absent the government's decision to tailor-make an opportunity to tempt him into doing so. Until that unfortunate and unique sequence of events, Dr. Nozette had been a fully loyal custodian of the nation's military and intelligence secrets for more than two decades.

Dr. Nozette's offense. Dr. Nozette's two counts of conviction arise from a single course of conduct. That conduct involves the manner in which Dr. Nozette billed government agencies for his services under the IPA agreements that his 501(c)(3) organization, ACT, had with those agencies. There is no dispute that Dr. Nozette performed all of the work he was supposed to perform, and performed it well. Nor is there any dispute that the government did not pay a penny more for his services than it had intended and committed to pay. But the precise manner in which Dr. Nozette billed the government for his services had the effect of causing government agencies unknowingly to pay ACT for expenses that were personal to Dr. Nozette. This had the further effect of understating his taxable income.

a. The IPA. Central to understanding how and why this happened is the

Intergovernmental Personnel Act of 1978 ("IPA"), 5 U.S.C. §§ 3371-3375, and, in particular, its cost accounting rules. The IPA is a specialized government contracting mechanism separate from the normal government contracting channels governed by the Federal Acquisition Regulations ("FAR"), 48 C.F.R. ch. 1. As its name suggests, it was originally created to allow government agencies to obtain on a temporary basis the services of individuals who worked for other government agencies, including public universities. *See generally* 5 U.S.C. §§ 3372-73. In its original conception, the IPA was designed primarily to allow state and local governments to expand their personnel resources through access to the specialized expertise of federal government employees. *See* GAO Report GGD-89-95: Intergovernmental Personnel Act of 1970: Intergovernmental Purpose No Longer Emphasized, ("GAO Report") (June 1989) (Ex. C), at 1. By the mid-1970's, however, its dominant function had become to give federal government agencies access to specialized knowledge or expertise possessed by non-federal personnel, particularly those in colleges and universities. *See id.* at 3. Federal agencies found "the program beneficial because of the flexibility it offer[ed] them in obtaining the temporary services of nonfederal personnel." *Id.* at 9.

Although the statute contained detailed rules concerning the compensation and benefits that would accrue to employees whose services were shared with another agency pursuant to an IPA agreement, *see* 5 U.S.C. §§ 3373-74, it did not contain provisions providing for the allocation of employee-related costs among the two government agencies involved in the exchange. Instead, pursuant to a general delegation of regulatory authority, *see id.* § 3376, the federal Office of Personnel Management ("OPM") issued guidelines advising on the sharing of such costs. *See* U.S. Office of Personnel Management, "Provisions of the IPA Mobility Program," ("OPM Webguide") (Ex. D).

In general, under these regulations, the "borrowing" agency would reimburse the "lending" agency for the direct costs associated with the borrowed employee but would not reimburse indirect costs, such as general and administrative expenses or other overhead. *See* OPM Webguide ("Agencies should not authorize reimbursement for indirect or administrative costs associated with the assignment"). Thus, the borrowing agency would compensate the lending agency for the salary and fringe benefits the lending agency was providing to the employee during the time the employee was actually working for the borrowing agency but would generally not cover items of indirect cost such as imputed rent for the lending agency's building. In the context of government agencies and universities, this made perfect sense: the agency receiving an employee's services would cover the direct costs associated with compensating that employee during the period of his or her service, but there was no reason to shift fixed costs that would otherwise be incurred by either institution regardless of the IPA.

In 1978, however, as part of the shift toward using the IPA to benefit federal agencies needing special expertise, Congress added "other organizations" to the list of entities that could furnish temporary employees to the federal government under the IPA. *See* Civil Service Reform Act of 1978, Pub. L. No. 95-454, 92 Stat. 1111. As relevant here, "other organizations" included "a non-profit organization which has as one of its principal functions the offering of professional advisory, research, education, or developmental services, or related services." 5 U.S.C. §§ 3371(4)(C).

This provision, which authorized the IPA agreements underlying this case, was simply grafted on to the preexisting intergovernmental structure of the Act, with no meaningful effort to define or customize the reimbursement or cost accounting rules for private non-profit institutions. *See* 5 U.S.C. §3372(e)(2) ("An assignment of an employee of another organization .

. . to a Federal agency, and an employee so assigned, shall be treated in the same way as an assignment of an employee of a State or local government to a Federal agency, and an employee so assigned, is treated under the provisions of this subchapter governing an assignment of an employee of a State or local government to a Federal agency."). The non-profit organizations the drafters of the Civil Service Reform Act undoubtedly had in mind were large research organizations functionally identical to state universities for billing and reimbursement purposes — for example, an established museum or NGO. With such organizations, too, there was no need to reallocate overhead or indirect costs between the borrowing and lending agencies and institutions.

Over time, however, the federal government increasingly began to enter into IPA agreements with small, special-purpose non-profits that were created precisely to take advantage of the IPA's flexible contracting provisions. Dr. Nozette's non-profit, ACT, was one such organization. As described more fully below, the idea of certifying ACT for use in IPA agreements was actually proposed to Dr. Nozette by a federal official whose agency needed Dr. Nozette's services. ACT never had more than two employees including Dr. Nozette, and it was run out of his primary residence. For all practical purposes, ACT was simply a corporate form wrapped around a scientist whose services the federal government needed.

As applied to such organizations, the basic cost accounting conventions that had been developed for government-to-government personnel assignments under the IPA were a more awkward fit. In particular, cost recovery became a genuine problem. An organization that qualifies to contract under the IPA, by definition, either receives other government funding, 5 U.S.C. § 3371(4)(A), (B), and (D), or is a specialized "nonprofit organization" 5 U.S.C. § 3371(C). The government-funded organizations, including universities, have other avenues by

which to recover costs, including other government contracts.[2] But 501(c)(3) organizations such as ACT often have no similar resources from which to recover their fixed, indirect costs. In addition, as applied to small, special-purpose non-profits of this kind, the line between a fringe benefit provided by the organization to its one or two employees and an indirect cost of maintaining the organization itself becomes quite blurry, because the organization and the individual are, in effect, one and the same. Because these organizations are often created to carry out an IPA agreement, they have no salary or benefit history for their employees. And they are often too small to have, for example, ERISA-qualified employee benefit plans.

An IPA agreement with a new, small, special-purpose non-profit organization created specifically to facilitate the employment of someone like Dr. Nozette thus resembles a personal services contract more than the interagency lending and cost-shifting arrangement that historically underlay the IPA and its associated rules. And the repeated efforts by all parties — driven by the considerable efficiencies created for both the government and for the private contractors — to force square pegs of this type into the round hole of traditional IPA agreements caused considerable distortion, confusion, and disuniformity in practice. They also led directly to Dr. Nozette's offenses in this case.

Standard terms in the form IPA contracts used by organizations such as ACT often made little sense in that context. For example, the ACT IPA agreements contained standard recitals applicable only to government counterparties. *See, e.g.*, Nozette NRL IPA Agreement (Ex. E) (asking submitter to "[i]ndicate the reasons for this mobility assignment and discuss how the work will benefit the participating *governments*," at 2, ¶ 21 (emphasis added); providing an area for submitter to "indicate all State employee benefits that will be retained by the State or local

[2] For example, it is Dr. Nozette's understanding that Lawrence Livermore National Laboratory ("LLNL") recovered its overhead costs on the Clementine project by directly billing the government through a large, general contract.

agency employee being assigned to a Federal agency," at 3, ¶ 31; and requiring submitter to "[i]ndicate: (1) Whether the Federal agency or State or local agency will pay travel and transportation expenses . . . ." at 3, ¶ 33). Moreover, because each agency determines the terms of its own IPA agreements, 5 U.S.C. § 3374(c), policies vary from agency to agency and terms vary from agreement to agreement, including with respect to issues central to Dr. Nozette's offenses. For example, despite the OPM's guidance, some agencies, including NASA, have at different times allowed for the reimbursement of General and Administrative ("G & A") costs. *See* NASA Desk Guide on the Intergovernmental Personnel Act (IPA), DG-11[3] ("NASA IPA DG-11") (Ex. F) at 9-10 (detailing process for approving indirect costs after explaining that "[f]or many years, OPM guidance indicated that agencies may not reimburse a non-Federal entity for administrative and overhead expenses . . . . Recent discussions with OPM disclosed that its guidance was not intended to prohibit the reimbursement of an allocable share of contractor indirect costs . . . ."); *see also* April 2003 Department of the Army Information Memorandum ("Army Memorandum") (Ex. H) (same).

The lack of central oversight in structuring and administering IPA agreements also led to vague and uncontrolled cost accounting. This is especially well-documented with regard to NASA. On July 18, 2007, the NASA Inspector General's Office released the results of an audit of NASA's IPA program. The NASA OIG Report found that NASA policies and practices for cost accounting and approval were so vague that NASA needed to "clarify the criteria for reasonable and allowable IPA agreement costs for fringe benefits, salary, and other miscellaneous and incidental costs (in concordance with OPM guidelines)." *NASA Could*

[3] NASA has updated its Desk Guide three times. DG-11 was in force from October 1999 to December 2008, with a set of amendments implemented in 2004. In December 2008, NASA released the Desk Guide currently in effect, NASA Desk Guide on the Intergovernmental Personnel Act, Version 3. In that version, NASA rescinded its policy of reimbursing for indirect costs. *See* NASA IPA Desk Guide 2008 (Ex. G) at 23 ("NASA no longer pays indirect or administrative costs").

Improve Controls and Lower the Costs of the Intergovermental Personnel Act Mobility Program ("NASA OIG Report") (Ex. I) at 5, 9.

b. The ACT IPA agreements. Dr. Nozette established ACT in 1990, and in 1991, it was qualified for tax-exempt status by the Internal Revenue Service ("IRS"). During the period relevant to this case, it employed Dr. Nozette and one other employee. It was physically located in a home office in Dr. Nozette's primary residence in Chevy Chase, Maryland. Like many other IPA-qualified organizations, its principal purpose was to facilitate IPA agreements between Dr. Nozette and certain federal government agencies that needed his services. It had no employment contract with Dr. Nozette, and maintained few formal employee benefit plans.

The impetus for using ACT to undertake IPA agreements came from the government itself. During the early 1990's, before ACT was qualified to undertake IPAs, Dr. Nozette was working at Lawrence Livermore National Laboratories ("LLNL") in California. From 1993-1997, while at LLNL, he was assigned to the Office of the Secretary of Defense and the U.S. Navy under an IPA agreement between LLNL and these agencies. In 1999, after funding became available for the Naval Research Laboratory's ("NRL") Mini-RF project, NRL was prepared to resume its arrangement with LLNL to obtain Dr. Nozette's services. However, the situation had changed: LLNL was interested in future funding from the Navy, and NRL preferred that Dr. Nozette's work not be impacted by any negotiations with LLNL.

In the summer of 1999, Dr. Nozette met with NRL officials who, upon learning of the existence of ACT, suggested that Dr. Nozette use it to enter into an IPA agreement of his own with NRL. Not only would this arrangement detach Dr. Nozette from LLNL, thereby avoiding a potential conflict of interest, it would be a more cost effective option for the agency than a traditional government contract with Dr. Nozette. A FAR contract would have required the

agency to cover the fully loaded costs of Dr. Nozette's services, which amounted to far more than NRL would pay LLNL under an IPA agreement. Moreover, using an IPA allowed NRL rather than ACT itself to administer program security measures. NRL accordingly agreed to pay ACT the same amount for Dr. Nozette's services that it would have paid LLNL under an IPA agreement. Dr. Nozette reasoned that he would not be disadvantaged financially, because he would be able to allocate the full amount of the contract to compensate himself and pay for any related benefits or costs he would now have to pick up. He also believed, through consultation with his accountants, that he would be able to claim tax deductions for business expenses as an independent contractor that had previously been personal in nature.

Thus, in January 2000, ACT entered into IPA agreements with NRL, in 2002 with the Defense Advanced Research Projects Agency ("DARPA"), and in 2004 with the National Aeronautics and Space Administration ("NASA"). All these IPA agreements related to his continuing work on the Mini-RF project. The NRL agreement provided for a contract term from January 13, 2000 to January 12, 2002 during which Dr. Nozette would be paid $95,100 per year, subject to a 4.5% negotiated adjustment. *See* NRL IPA (Ex. E) at 2. The DARPA IPA contract, which ran from March 18, 2002 to March 17, 2004, provided a salary of $129,775. DARPA IPA (Ex. J) at 2. The NASA IPA contract ran from March 1, 2004 to February 28, 2006, and provided a salary of $141,718. NASA IPA (Ex. K) at 2.

The IPA agreements were ambiguous concerning the fringe benefits that could be paid out as direct costs in addition to the specified salaries. The NRL IPA agreement was the most detailed of the three, listing FICA, fringe benefits, and retirement payouts.[4] NRL IPA (Ex. E) at 3. At ¶ 31, the contract states that "[a]ll benefits for which the employee is eligible as an

[4] The government refers to an attachment to the NASA IPA agreement in the Information, at 6-7, ¶ 17. While a document estimating the apportionment of benefits does exist, it did not form part of the final NASA IPA agreement, nor is it incorporated therein by reference.

employee of ACT will be retained during the period of assignment." *Id.* The remaining two contracts simply state that the contracting agency "will reimburse Alliance for Competitive Technology for Dr. Nozette's salary and for the ACT share of employee benefits equivalent to 40% of base salary." DARPA IPA (Ex. J) at 3, ¶ 26; NASA IPA (Ex. K) at 3, ¶ 26 ("approximately 40% of base salary"). All three contracts address the annual leave benefit separately, stating, in essence, that ACT's leave policies would continue to apply. *See* NRL IPA (Ex. E), DARPA IPA (Ex. J), and NASA IPA (Ex. K) at 2, ¶ 25.

Regarding cost accounting and invoicing procedures, the contracts are nearly silent. The NRL IPA agreement's only specific provisions on cost accounting relate to travel reimbursements. NRL IPA (Ex. E) at 3, ¶ 33. Otherwise, there is no direction concerning invoicing or billing in any of the IPA agreements, except an address to which invoices should be sent. *See, e.g.,* NASA IPA (Ex. K) at 3, ¶ 25.[5]

In administering ACT's IPA agreements, Dr. Nozette made two critical errors that resulted in the offenses for which he is now to be sentenced. First, he brought a scientist's sensibility rather than a lawyer's sensibility to the IPA agreements, focusing on what he understood to be the economic substance of the arrangement, rather than its particular contractual form. In his mind, as confirmed by discussions he had with finance officials at NRL, DARPA, and NASA,[6] the contracting agencies had allocated a certain amount of money to purchase his services through ACT; they expected to pay that full amount; and ACT was entitled to receive that full amount for the contracted work. Dr. Nozette believed that the mechanics of invoicing

[5] The NASA IPA contains two ¶¶ 25, one at page 2 and one at page 3. The one cited here should be numbered ¶ 27, but appears as ¶ 25 in the document.

[6] Dr. Nozette discussed aspects of his invoicing methodology under the IPA agreements with NRL, DARPA, and NASA contracting and finance personnel. He understood from those conversations that detailed cost accounting was not required as long as the sum total billed did not exceed the funds allocated for the IPA. Several government officials told him that the government agencies regard IPA agreements as a species of grant.

and how the funds were used were essentially of no concern to the government. Dr. Nozette also saw little or no distinction between ACT and himself: ACT was a mere shell that operated out of Dr. Nozette's home and was, in his mind, simply Dr. Nozette (plus, briefly, one other employee). The funds ACT received were meant to compensate him and were available for his use.

Consistent with this general understanding, Dr. Nozette billed against the IPA as if it were, in effect, a personal services contract: he simply divided the total annual amount of the contract into twelve equal parts and had ACT bill the government for that fixed amount monthly. *See* Nozette Sample Invoices (Ex. L). He made no particular effort to itemize particular salary or fringe benefit items in these invoices, because ACT did not have a formal salary or benefit structure; in Dr. Nozette's mind, ACT was simply a contracting vehicle to simplify and reduce the cost to the government of purchasing his expertise. Likewise, when invoices were paid, he used the incoming funds to defray a wide variety of expenses he was incurring. Some of these could properly be regarded as business expenses of ACT, while others were more personal in nature. But without any rigorous or systematic effort to distinguish the different types of expenses, the line between business and personal expenses quickly became blurry and indistinct.

Dr. Nozette's second related and even more critical error was to use as a template for these invoices the only form of IPA invoice he had: a memorandum of instructions and guidelines containing template forms that he had been given by NRL in his orientation packet. *See* NRL Instructions (Ex. M). These instructions recited that the invoiced amount was for "cost of pay (P) and related fringe benefits" of the employees whose services were being procured under the IPA agreement. *See id.* at 6; *see also, id.* at 7 (Organization will "make salary payments to employee, make contributions for fringe benefits on his/her behalf . . . and bill NRL for such costs."). Thus, ACT's invoices to the government all used the same boilerplate

recitation of "salary" and "fringe benefits," even though, as described above, Dr. Nozette's actual billing methodology was not specifically tied to salary or benefit figures, either actual or imputed.

This method of billing and invoicing resulted in each claim for payment being technically false, in that the amount billed was not actually tied to a calculation of the "salary and fringe benefits" due for that period. The expected work was done, and done well; the claims were not false in the sense that they billed the government only for services it had actually received. And the government each month paid no more than it expected to pay for the services Dr. Nozette performed; officials in each contracting agency understood that Dr. Nozette was charging the full annual amount authorized under the IPAs for his services. But the invoices incorrectly described the methodology Dr. Nozette was using to arrive at the invoiced amounts, and what those amounts represented. This was legally improper, and Dr. Nozette has acknowledged that by pleading guilty to the conspiracy to submit false claims charged in Count One of the Information.

The same basic problem also gave rise to the tax evasion to which Dr. Nozette has pled guilty in Count Two. When ACT received the installment payments under the IPA agreement that Dr. Nozette had improperly billed as being for "salary and fringe benefits," those amounts were generally treated by Dr. Nozette as belonging to him. They were used to cover expenses without any careful effort to distinguish between what was personal in nature and what was business-related. Believing that the contracting agencies were indifferent to his relationship with ACT or how he used the money it received, Dr. Nozette made no distinction between personal expenses of his and business expenses of ACT. To his mind, what, after all, was the difference between an employee "fringe benefit" and a personal benefit to Dr. Nozette when he was ACT's only employee, and the money had no other purpose than to compensate him for his work?

Many formerly personal expenses in fact became business expenses of ACT when Dr. Nozette became an independent contractor, and although Dr. Nozette should have kept more detailed records and attempted a more systematic division between business and personal expenses, there is considerable ambiguity surrounding the proper tax treatment of expenses incurred by the sole proprietor of a small tax-exempt entity such as ACT. *See, e.g., Universal Church of Scientific Truth v. United States,* 74-1 U.S.T.C., 1973 WL 718 (N.D. Ala. 1973). As a result, when ACT disbursed IPA funds for expenses that, had the matter been examined, should properly have been regarded as personal to Dr. Nozette, it typically failed to classify those payments as personal income received by Dr. Nozette from ACT. Because ACT was a 501(c)(3) organization, using tax-exempt funds that ACT received to defray household expenses without first declaring those funds as personal income to Dr. Nozette had the effect of evading Dr. Nozette's tax obligations.

c. Post-ACT IPA developments. When these problems came to light, Dr. Nozette switched from the IPA agreement back to the more traditional government contract governed by the FAR. That is how he performed his work on the Mini-RF project after 2006.

It is important to note that the FAR contract cost the government significantly more than the IPA agreement did to obtain the same services from Dr. Nozette. To cover the fully-loaded cost of Dr. Nozette's services under the FAR in a manner that provides him roughly the same disposable income, NASA was obliged to compensate him at an hourly rate of $155. Even using the final NASA IPA agreement, which was the most lucrative in the series, and calculating his hourly rate on the total value of the contract, including both salary and benefits at 40% for the 2080 hours per year on which his contracts were based, his hourly cost to the government under the IPA agreements was $104.16.[7] Thus, in the span of a week[8] the government saw a 49%

[7] From October 2005 to February 28, 2006, Dr. Nozette's maximum yearly take-home was $216,663 ($154,759.60 (salary) + 40% (benefits) = $216,663). $216,663/2080 = $104.16.

increase in the hourly cost of obtaining Dr. Nozette's services. There is no dispute that the contracting approach he used after 2006 under the FAR was lawful and appropriate, or that his tax computations were correct after the change.

The Mini-RF project, which has been ongoing since 1999 and was funded during the relevant years by the IPA agreements at issue in this case, recently came to fruition. The total cost of that project to the government was approximately $200 million. On May 8, 2008, Dr. Nozette received a NASA Group Achievement Award for his significant contributions to the successful delivery of the Mini-RF payloads on the Indian Chandrayaan-1 and LRO missions. In the summer of 2009, the LRO and Chandrayaan-1 satellites orbited the moon while coordinating their gathering of data in a way that allowed for the most authoritative confirmation to date that frozen water exists at the polar surfaces of the moon — confirming findings Dr. Nozette had made over a decade earlier.

Dr. Nozette's guilty plea and cooperation. Based on ACT's sloppy administration of the IPA agreements, Dr. Nozette pled guilty to one count of conspiracy to defraud the government via false claims and one count of tax evasion. Count One charged that under each of the IPA contracts, Dr. Nozette knowingly invoiced the government for expenses ACT had not incurred. These consisted of a portion of the fringe benefits claimed at 40% of Dr. Nozette's and his employee's salaries. The government's loss calculation recognizes that certain expenses ACT incurred were properly considered benefits under the IPA contracts and so were eligible for reimbursement. The plea agreement therefore reflects a gross loss from the offense of $265,205.57, which is less than the full 40% fringe benefit amount reflected on each invoice.

Count Two charged Dr. Nozette with underreporting his income, and thereby evading taxes due. As part of the plea, Dr. Nozette agreed to meet with and help the IRS calculate the

[8] The L3 contract with ACT was signed on March 7, 2006 and his NASA IPA ran through February 28, 2006.

back taxes he owes, along with the interest and penalties due on those taxes, and to pay the amounts the IRS determines he owes. That process is now complete and Dr. Nozette has paid off his entire tax liability. *See* Letter from D. Greenstein, Revenue Officer, IRS, to Burton J. Haynes, Notice of Case Resolution (Aug. 3, 2010) (Ex. N).

The plea agreement also required Dr. Nozette to continue to cooperate with the government in investigating his offenses, which he has done. Prior to Dr. Nozette's arrest on the attempted espionage charges, the government acknowledged that Dr. Nozette had been cooperating consistently and in good faith, and recommended the three-level decrease in his offense level for acceptance of responsibility.

Finally, the plea agreement also provided Dr. Nozette an opportunity to receive a downward departure in consideration of substantial assistance to the United States in the investigation or prosecution of other offenses. The possibility of receiving a reduced sentence more commensurate with his true culpability through a § 5K1.1 motion was a substantial consideration in Dr. Nozette's decision to plead guilty.[9] Even before the plea agreement was signed, Dr. Nozette provided the government with information relating to potential wrongdoing by others in an effort to make amends for his own errors in judgment. Since that time, Dr. Nozette has continued to provide information and assistance to the government in ongoing investigations. He has met with the AUSA in this case and multiple agents from different agencies, including NASA, the FBI, and the Department of the Treasury. He has been asked and agreed to participate in an undercover role in their investigations. He has recorded numerous conversations with persons of interest to investigating agencies and has met with the AUSA and/or investigating agents numerous times as part of his cooperation efforts.

[9] The other primary consideration was the government's agreement not to charge Dr. Nozette's wife with any offenses.

SENTENCING GUIDELINES CALCULATION

With a single exception, the Plea Agreement sets forth an agreed guidelines calculation. Dr. Nozette's sentencing request set forth in the next section of this Memorandum is driven primarily by a request to depart downward from the guidelines sentencing range based upon equitable factors. The agreed aspects of the applicable guidelines calculation are as follows:

Count I (Conspiracy to Submit False Claims):

(a)	Base Offense Level (2X.1.1; 2B1.1(a))	6
(b)	Specific Offense Characteristics	
	i. Loss more than $200,000.00 but less than $400,000.00 (2B1.1(b)(1)(G))	12
(c)	Role in the Offense	
	i. Aggravating Role (Leader in Criminal Activity) (3B1.1(c))	2
	Total	20

Count 2 (Tax Evasion):

(a)	Base Offense Level	
	More than $200,000.00 Tax Loss (2T1.1(a)(1); 2T4.1(G))	18
(b)	Specific Offense Characteristics	
	i. Failure to Correctly Report or Identify Income of More Than $10,000/yr. From Criminal Activity (2T1.1(b)(1))	2
	Total	20

Acceptance of Responsibility:

i.	Acceptance of Responsibility (3E1.1(a))	-2
ii.	Assistance (3E1.1(b))	-1
	Total	-3

The sole dispute affecting the guidelines calculation regards the grouping of the two counts. The government, and the PSR in turn,[10] treat the counts as independent groups in

[10] The Draft PSR states: "The government believes that the conspiracy and tax offenses are not subject to grouping and the defendant is subject to a two level sentencing enhancement pursuant to § 3D1.4 The defendant reserves the right at sentencing to argue that the conspiracy and tax offenses should be grouped and that his sentencing level should not be increased by § 3D1.4." PSR at ¶ 4.

calculating the final offense level, thus imposing an additional two level enhancement under section 3D1.4. Based upon the agreed criminal history category of I, the government and PSR arrive at a final offense level of 19, a guidelines sentencing range of 30-37 months, and a fine range of $6,000-$60,000. U.S.S.G. § 5E1.2(c)(3). However, we submit that the two counts should be grouped under the guidelines. If the counts are grouped, the correct final offense level is 17, with a guidelines sentencing range of 24-30 months, and fine range of $5,000 to $50,000.[11]

I. THE SENTENCING GUIDELINES REQUIRE COUNTS I AND II TO BE GROUPED.

Section 3D1.2 of the sentencing guidelines directs that "[a]ll counts involving substantially the same harm shall be grouped together into a single Group." It then lists four circumstances where "counts involve substantially the same harm," U.S.S.G. § 3D1.2, including when counts involve the same victim and the acts or transactions constitute part of a common scheme, *see* U.S.S.G. § 3D1.2(b), and when one of the counts embodies conduct that serves as a specific offense characteristic in the guideline applicable to another count, *see* U.S.S.G. § 3D1.2(c). The two counts to which Dr. Nozette has pled qualify for grouping under both § 3D1.2(b) and § 3D1.2(c). They both caused harm to the United States Treasury as a common victim and resulted from the same, unified course of conduct. And because the agreed guidelines calculation for Count Two includes a two-level enhancement under § 2T1.1(b)(1), which increases the offense level for tax evasion when it involves a failure to report income from other illegal activity, the failure to report income from the conduct underlying Count One has already

[11] Dr. Nozette has been incarcerated since his arrest on the attempted espionage charges on October 19, 2009. The Court revoked Dr. Nozette's personal recognizance bond in this case on August 3, 2010, but later amended that order to reflect that Dr. Nozette's release was revoked on October 28, 2009 so that he could receive full credit for time served. *See* Nunc Pro Tunc Order (11/18/2010, Dkt. # 32). The sentence the Court imposes should reflect the time Dr. Nozette has already served.

served to enhance the offense level for Count Two. It should not add two *more* levels through a failure to group these closely related counts.

A. The Counts Must Be Grouped Under § 3D1.2(b) Because They Involve the Same Victim and Constitute Part of a Common Scheme or Plan

Section 3D1.2(b) states that counts are to be grouped when they "involve the same victim and two or more acts or transactions connected by a common criminal objective or constituting part of a common scheme or plan." U.S.S.G., § 3D1.2(b). Here, both counts resulted from a single course of conduct involving the misuse of contract funds owed to ACT to defray personal expenses of Dr. Nozette, and had a single victim, the federal Treasury.

The core misconduct underlying both counts is Dr. Nozette's use of federal funds obtained by his tax-exempt IPA organization to pay for personal expenses. Both the false claims and the tax evasion grow directly out of this single *actus reus*. His ACT invoices incorrectly reported to the contracting agencies that certain funds went to pay for corporate expenses of ACT, and Dr. Nozette treated them the same way for tax purposes. The funds ACT obtained were all legitimately earned through work performed by Dr. Nozette, but the use of some of these funds was mischaracterized as being for ACT's benefit rather than his own. This single distortion resulted in the commission of both offenses. Their root cause was also the same: the failure to respect the corporate separateness of ACT from Dr. Nozette himself. To treat the offenses as distinct would be wholly artificial. The acts in question constitute a single, common course of action with a common objective: to maximize the value to Dr. Nozette of funds earned by ACT under the IPA agreements.[12]

[12] The offenses occurred, in essence, because Dr. Nozette expected the IPA agreements with ACT to have no significant net impact on his personal finances as compared with his previous IPA assignments at LLNL. Having ACT defray otherwise personal expenses with the tax-exempt income it received under the IPA agreements was designed to ensure that the ACT IPA arrangement was economically equivalent to the compensation and reimbursements Dr. Nozette previously received from LLNL.

Courts have found a common criminal objective when the defendant seeks to obtain money from a victim and retain it for his own use. *See United States v. Young*, 266 F.3d 468, 483 (6th Cir. 2001) (finding that grouping under § 3D1.2(b) was proper because the City was the common victim of offenses that "were all part of one overall scheme to obtain money from the City and convert it to the personal use of Defendant"); *United States v. Cusumano*, 943 F.2d 305, 313 (3d Cir. 1991) (finding grouping under § 3D1.2(b) proper because "the unlawful kickbacks, the embezzlement, the conspiracy, the travel act violations and the money laundering were all part of one overall scheme to obtain money from the Fund and to convert it to the use of [defendants]"). The counts here reflect the same common objective recognized in *Young* and *Cusumano*: improperly acquiring and using federal contract funds.

Both counts also had the same victim. For grouping purposes, the victim of Dr. Nozette's crimes is the entity "most seriously affected by the offense." U.S.S.G. § 3D1.2, Application Note 2. The entity most seriously affected by both offenses — indeed, the only victim of this scheme — was the federal Treasury. Tax evasion is a crime against the treasury of the collecting government. *See United States v. Brickey*, 289 F.3d 1144, 1155 (9th Cir. 2002) (finding that the United States government is the "true victim" of tax evasion counts); *cf. also Pasquantino v. United States*, 544 U.S. 349, 356 (2005) (finding that evasion of Canadian taxes "deprived Canada of that money, inflicting an economic injury"). Likewise, obtaining money under a federal government contract — at least in circumstances such as these, where the work was actually performed — inflicts only economic harm, and such harm obviously has its primary impact on the federal Treasury. *See Allison Engine Co., Inc. v. U.S. ex rel. Sanders*, 128 S.Ct. 2123 (2008) (finding that all the funds used to pay government contracts "ultimately came from the U.S. Treasury"); *United States ex rel. Marcus v. Hess,* 317 U.S. 537, 541 (1943) (stating that

the purpose of the False Claims Act was to prevent frauds on the Treasury) (quoting *United States v. Griswold,* 24 F. 361, 366 (Or. 1885)); *United States v. Wright*, 12 F.3d 70, 74 (6th Cir. 1993) ("the payment of false claims harms the U.S. Treasury").

Although Dr. Nozette was convicted of conspiracy to defraud the United States government through filing incorrect invoices with three different federal agencies, there is no sound legal basis for treating one federal fiscal pocket as a victim distinct from another. Although the agencies were the vehicles through which the invoices were filed, the federal Treasury held the funds paid out to ACT as a result. In *United States v. Stewart*, 321 F. Supp. 2d 652 (D. Md. 2004), the United States argued that the victim of a fraud involving conversion of federal employee survivor benefits was the specific fund that paid them out, the Civil Service Retirement System Fund, whereas the defendant argued the United States had to be regarded as a single, unified entity for purposes of determining the amount of restitution owed by netting out taxes that had been withheld. The district court agreed with the defendant, finding that the difference between "the account especially designated for civil service retirees" and "the Treasury's general revenue fund" was "little more than an accounting matter." *Id.* at 656. Because (absent special circumstances not present here, such as federal trust funds) the Treasury is always able to credit restitution payments to an agency it "chooses to characterize as the 'victim' of the fraud or deceit," the Court held that the Treasury as a whole, and not the CSRS Fund viewed in isolation, was the proper victim for purposes of loss analysis. *Id.* at 656. Because the effects of both of Dr. Nozette's offenses were purely pecuniary in nature, they were borne by the United States Treasury alone, and it was the entity "most seriously affected by" each offense. U.S.S.G. § 3D1.2.

Because both offenses had a single victim and were part of a common scheme, they should be grouped under U.S.S.G. § 3D1.2(b).

B. The Counts Should be Grouped Under § 3D1.2(c) Because the Conduct Underlying Count One is a Specific Offense Characteristic in Count Two

Counts should also be grouped "when one of the counts embodies conduct that is treated as a specific offense characteristic in, or an adjustment to, the guideline applicable to another of the counts." U.S.S.G., § 3D1.2(c). That is precisely the situation here.

Count Two includes § 2T1.1(b)(1) as a specific offense characteristic. Section 2T1.1(b)(1) applies a two-level enhancement in the offense level for tax evasion if the defendant failed to report over $10,000 in income that was derived from other illegal activity. That enhancement has been applied here by agreement of the parties, because the tax evasion entailed the failure to report more than $10,000 of personal income Dr. Nozette derived from billing the government, through ACT, for personal expenses — the conduct underlying Count One. Thus, Count One "embodies conduct that is treated as a specific offense characteristic in . . . the guideline applicable to" Count Two. U.S.S.G. § 3D1.2(c).

When this occurs, section 3D1.2(c) calls for grouping of the two counts. It is error "where, as here, a count is predicated on conduct that is used to enhance a separately grouped count, and the two counts are not grouped together under section § 3D1.2(c)." *United States v. Leung*, 360 F.3d 62, 69 (2d Cir. 2004) (vacating portions of lower court's judgment and remanding for resentencing); *see also United States v. Hankin*, 931 F.2d 1256, 1265-66 (8th Cir. 1991). Indeed, several courts have specifically held that tax evasion counts must be grouped with underlying fraud counts when the two-level enhancement in § 2T1.1(b)(1) is applied to increase the offense level for the tax evasion. *See, e.g., United States v. Haltom*, 113 F.3d 43, 46 (5th Cir. 1997) (finding that § 3D1.2(c)'s "definition removes any doubt that [the defendant's]

offenses must be grouped" where § 2T1.1(b)(1) was applied to tax evasion count based upon the conduct underlying mail fraud count); *United States v. Draskovich*, 159 F. Supp. 2d 1154, 1156 (D. Minn. 2001) (finding that when § 2T1.1(b)(1) was applied to tax evasion count, "[b]ecause the conduct underlying Defendant's mail fraud, which has already been weighed against him in the mail fraud count, constitutes a specific offense characteristic of Defendant's tax count, section 3D1.2(c) . . . mandate[s] the grouping of these counts"). Because § 2T1.1(b)(1) was already used to increase the offense level for Count Two by two levels based upon the conduct charged in Count One, Counts One and Two should be grouped under U.S.S.G. § 3D1.2(c).

SENTENCING REQUEST

Dr. Nozette had originally intended to request a downward departure from the indicated guidelines range based upon his substantial assistance to the United States and the anticipated motion that was to be filed by the government. *See* U.S.S.G. § 5K1.1. In the wake of his arrest on the attempted espionage charges, however, no such motion has been filed. Nonetheless, since the Guidelines are now merely "advisory,"[13] this Court retains discretion to sentence Dr. Nozette on these offenses based upon the equitable sentencing factors set forth in 18 U.S.C. § 3553. Dr. Nozette submits that his significant cooperation with the authorities plus the statutory sentencing factors warrant a sentence substantially below that provided for in the Guidelines. The Court's authority to depart downward extends to all aspects of the criminal sentence.

With respect to incarceration, Dr. Nozette respectfully requests maximum leniency from this Court, both in consideration of his extensive cooperation with law enforcement and because the relevant sentencing considerations demonstrate that imprisonment for a term of years is not appropriate for the offenses in this case. Dr. Nozette further requests that the court accept the

[13] *See United States v. Booker*, 543 U.S. 220 (2005); *United States v. Blalock*, 571 F.3d 1282, 1285 (D.C. Cir. 2009) ("In the wake of the Supreme Court's decision in *United States v. Booker,* [], the Sentencing Guidelines 'are now advisory'") (quoting *Gall v. United States*, 552 U.S. 38 (2007)).

PSR's recommendation and impose no fines given his financial circumstances and successful effort to pay back taxes, which already include penalties and interest, under Count Two. *See* Letter from D. Greenstein, Revenue Officer, IRS, to Burton J. Haynes, Notice of Case Resolution (Aug. 3, 2010) (Ex. N). Finally, restitution under Count One (the only Count for which it is authorized) should not exceed $62,593.01 to reflect the actual net loss suffered by the Treasury, taking into account the fringe benefit expenses incurred by Dr. Nozette that could properly have been charged to the government under the ACT IPA agreements. The restitution order should also account for Dr. Nozette's straitened financial circumstances by setting a schedule of nominal payments to begin when he is released from prison.

I. DR. NOZETTE SHOULD RECEIVE A SENTENCE BELOW THE GUIDELINES SENTENCING RANGE FOR INCARCERATION.

Despite the government's failure to file a § 5K1.1 motion, in the post-*Booker* era, while "a sentencing court is required 'to consider Guidelines ranges' applicable to the defendant, [it] is permitted 'to tailor the sentence in light of other statutory concerns as well.'" *United States v. Adewani*, 467 F.3d 1340, 1341 (D.C. Cir. 2006) (quoting *Booker*, 543 U.S. at 245-46). In that regard, this Circuit has held that "[a] sentencing judge cannot simply presume that a Guidelines sentence is the correct sentence. To do so would be to take a large step in the direction of returning to the pre-*Booker* regime." *United States v. Pickett*, 475 F.3d 1347, 1353 (D.C. Cir. 2007). Instead, the "correct" approach "is to evaluate how well the applicable Guideline effectuates the purposes of sentencing enumerated in § 3553(a)." *Id.* Here, the equitable sentencing factors the Court is directed to consider under section 3553 suggest that a multi-year prison sentence is far too harsh a punishment for the rather technical offenses in Counts One and Two of the Information in this case. Not only did Dr. Nozette fulfill his agreement to provide substantial assistance to law enforcement authorities, but no good purpose would be served by

ordering Dr. Nozette incarcerated for a term of years here, especially when he is already going to be serving a far longer term of imprisonment on the attempted espionage charges.

A. Dr. Nozette Provided Substantial Assistance to Law Enforcement Authorities in the Investigation of Other Offenses.

Although the government declined to file a § 5K1.1 motion after Dr. Nozette was arrested for attempted espionage, Dr. Nozette in fact furnished substantial assistance to the government in its investigations of other suspected wrongdoing prior to his arrest. Dr. Nozette provided the government with information regarding possible criminal conduct that was known only to the participants, whom Dr. Nozette had occasion to observe during the course of his work. Indeed, Dr. Nozette has been providing information to the government since before his plea agreement was signed. His cooperation has required sealing this case from the filing of the Information in December 2008, (*see* Order to Seal (12/17/2008, Dkt. # 3), until October 2009, after he was indicted on charges of attempted espionage, (*see* Order Modifying Order to Seal (10/22/2009, Dkt. # 21). Throughout the cooperation process, Dr. Nozette gathered and turned over to the government documentary evidence useful to federal investigators and performed clandestine surveillance for the Federal Bureau of Investigation ("FBI"). He has recorded numerous conversations with persons of interest to federal law enforcement and has met with the AUSA and/or FBI and NASA agents more than a dozen times as part of his cooperation efforts.

Dr. Nozette's information was significant and useful. Although it would not be appropriate to expose details on the sentencing record, Dr. Nozette furnished information to federal investigators that concerned potential misconduct by important participants in government contracting, including some public officials. The sensitivity of these efforts required that this matter remain under seal for a considerable period of time, so that the individuals in question would continue to speak freely around Dr. Nozette. As a long-time participant in space

research and contracting, Dr. Nozette was able to become privy to information that otherwise only the wrongdoers knew. The value of this information is great, not just because of its content, but because it was otherwise nearly impossible to obtain. Through Dr. Nozette, the government has learned of potential misconduct and certain patterns of fraudulent behavior that might otherwise have evaded detection entirely. Dr. Nozette's information will be vital for the government in any investigation and prosecution of the underlying acts. U.S.S.G. § 5K1.1(a)(1).

At every moment throughout the cooperation process, Dr. Nozette was fully candid and provided as much information as he knew. *Id.* § 5K1.1(a)(2). He always made clear where he had directly witnessed events or conversations and when he had documents to help support the information. He then made available to the government every document in his possession he felt was relevant, and in some instances where he did not already possess the material but could legally obtain it, he took it upon himself to gather additional documentation to aid the government in its investigation.

The nature and extent of Dr. Nozette's cooperation were likewise exemplary. *Id.* § 5K1.1(a)(3). Extending himself a great deal, Dr. Nozette agreed at the government's request to covertly engage a number of individuals in conversations and to record those conversations surreptitiously. Dr. Nozette held extensive and frequent meetings with federal prosecutors and agents, who guided his activities and instructed him. And his efforts yielded hours of taped evidence from a number of different individuals. Dr. Nozette invested scores of hours of his time in this endeavor, and despite a sincere and well-founded fear for his personal safety due to the character and history of certain of the individuals involved,[14] as well as deep misgivings about betraying some individuals who were long-time professional colleagues, Dr. Nozette

[14] Dr. Nozette had seen at least two of the relevant individuals in possession of firearms and knows at least one is a member of a recognizable and often violent hate group.

attempted to make amends for his own misconduct by complying with every request and instruction given to him by federal prosecutors and agents and by doing his best to assist their investigative efforts. § 5K1.1(a)(4).

A defendant who pleads guilty and does what Dr. Nozette did here should receive "a very substantial sentencing benefit." *United States v. Gales*, 560 F. Supp. 2d 27, 29 (D.D.C. 2008). Dr. Nozette's substantial assistance to authorities is precisely the kind of cooperation the law envisions and encourages a sentencing court to take into account by departing downward from otherwise applicable guidelines range.[15]

B. The Interests of Justice Warrant a Lenient Sentence

In addition to the value of Dr. Nozette's assistance to the government described above, the Court should also consider a number of factors in order to "impose a sentence sufficient, but not greater than necessary" to meet the interests of justice. 18 U.S.C. § 3553. Those factors support Dr. Nozette's request that he be sentenced with maximum leniency.

First, the circumstances surrounding the commission of these offenses is critical to understanding their seriousness. As described above, these offenses are intimately bound up with uncertainties, ambiguities, and technicalities associated with contracting under the IPA. The IPA mechanism, which the government agencies and Dr. Nozette used to enter into business with one another, simply was not well-adapted for use by a small, personal-service non-profit such as ACT. To have abided by the most conservative interpretation of the IPA regulations would have defeated one of the mobility program's stated goals: to keep the IPA assignee on equal financial footing during her assignment. *See* NASA IPA DG-11 (Ex. F) at 12 ("The intent

[15] The government will no doubt object that Dr. Nozette committed the additional offense of attempted espionage while cooperating, but that mistakes where the blame for that conduct really lies: it was the government that engaged in the outrageous tactic of setting up a sting operation against its own cooperator, thereby accepting the benefits of his cooperation while simultaneously scheming to destroy his ability to obtain the benefits of it by inducing him to commit further, far more serious crimes. Any legitimate national security concerns relating to Dr. Nozette's conduct could have been fully addressed through a short telephone call to Dr. Nozette's counsel.

of the IPA is that assignees should not lose income by accepting the assignment"); NASA IPA Desk Guide 2008 (Ex. G) at 29 ("Detailees should not lose income by accepting an assignment in the IPA program"). And yet to have refused to enter into the IPA program would have inflicted a greater financial cost on the government for the same services, as was amply demonstrated when Dr. Nozette in fact switched over to a FAR contract. Dr. Nozette did all of the work he was contracted to perform, and did so successfully. And the ACT IPAs consumed only the total amount the government had budgeted for those contracts. His offenses grew instead out of the loose, unsystematic, and self-interested manner he employed for invoicing and administering the contracts and spending their proceeds. The conduct was careless and improper on a small scale, but it was not extreme or antisocial. And importantly, it did not deprive the public of the high-quality expert services for which the government had contracted. Had Dr. Nozette simply agreed *ex ante* that he would bill the same total amount of the contract as salary, with no provision for benefits, and declared all of it as income, he would not be before the Court for sentencing on these charges.[16]

Although it was Dr. Nozette's duty to ensure that documents he submitted to the U.S. government were accurate and proper, he urges the court to note that his conduct was not motivated by any desire to overbill the government. As evidenced by the 49% jump in his hourly rate when he moved from assignment under the IPA mobility program to a contract governed by the FAR, this arrangement was meant to *save* the government money, not bilk it. Thus, while it is never in the government's interest to receive false claims, Dr. Nozette's invoices were not part of a scheme to cheat the government out of money it would not otherwise have

[16] Because the IPA regulations did not at this time include any clear or specific rules on cost accounting, Dr. Nozette probably would have been permitted to bill the government ratably for the total value of the contract if the invoices had accurately described what he was doing. However, by using the template from the initial NRL packet, Dr. Nozette submitted invoices reciting that they were for "salary and fringe benefits," which was not accurate based upon how ACT was conducting its business.

paid. These circumstances all color the seriousness of his crime in less dark shades than the more typical attempts to defraud the government by charging for services that were never provided or goods that were never delivered.

Moreover, at the time he committed these offenses, Dr. Nozette's perception that the legal formalities of IPA agreements could be essentially disregarded and that IPA agreements could be treated as a form of fixed-cost grant, the full amount of which could be invoiced irrespective of the timing or amount of actual costs, was widely shared and was indeed reflected in the manner in which NASA officials reviewed these invoices. *See* NASA OIG Report at 5 (Ex. I) (finding that NASA's review of invoices was limited to a process where, "[u]pon receipt [of IPA home institutions' invoices], the NASA Center's finance or technical organization compared each invoice's costs with the agreement's budget limit. The IPA assignee's technical organization representative (usually a NASA employee) then conducted a cursory review for obvious errors"). Indeed, in numerous conversations over the years, Dr. Nozette had received the impression that agency contracting and finance personnel were indifferent to the particulars of ACT's arrangements with him as long as the work was performed for the budgeted amount, which they regarded as a grant to the IPA recipient.[17] While Dr. Nozette should have known better than to rely on this kind of information, and should not have submitted invoices that did not accurately represent the basis for ACT's charges, it was not the exception but rather the rule to approach IPA cost accounting in this relaxed manner at the host institutions.

For their part, Dr. Nozette's improper tax filings emanated from Dr. Nozette's perspective that because the government was saving money due to his having set up ACT to be

[17] Among other things, agency personnel told him over the years that it was acceptable to bill for expenses before they had been incurred, as long as the total budgets were not exceed; that it was acceptable to estimate various costs, again as long as the IPA total budgets were respected; that IPAs were carried on agency books as grants, with flat sums allocated to the agency to pay for them; and that the agencies did not care about the particular compensation arrangements that existed between ACT and himself.

able to enter into an IPA agreement with the government, he should be financially no worse off than he otherwise would have been. This caused him to pay for expenses anywhere near the already blurry line between ACT and himself with pretax dollars. Moreover, in assessing the seriousness of the offense in Count Two, it is important to remember that the gross loss charged (approximately $260,000) occurred not in one tax year but represents the aggregate loss over the course of five years. And, as we make clear below in the discussion of restitution, even that gross loss figure substantially overstates the actual *net* loss to the government from Dr. Nozette's conduct. 18 U.S.C. § 3553(a)(1) and § 3553(a)(2)(A).

Second, extended incarceration on these charges is not necessary to "afford adequate deterrence to criminal conduct." 18 U.S.C. § 3553(a)(2)(B). Prior to these offenses, Dr. Nozette had no criminal history, and this experience has already been painful enough to him and damaging enough to his life and career that his risk of recidivism is exceptionally low.[18] 18 U.S.C. § 3553(a)(2)(C). Indeed, he will already be serving a lengthy sentence on the attempted espionage charge. His misconduct here should be weighed against a lifetime of law-abiding and socially useful behavior. Moreover, since these offenses were committed and until he was terminated,[19] Dr. Nozette worked in the same field and on the same government projects under an appropriate contracting mechanism. He obtained new tax counsel, and his tax filings since tax year 2005 were reviewed by his counsel.

Dr. Nozette also accepted responsibility for his conduct, worked to help the government in its investigation of the facts and circumstances surrounding his offenses, and focused his

[18] The government may object that the recent attempted espionage charges reflect a propensity for further criminal conduct and the need for stronger deterrence, but ironically, according to the government's allegations, the prospect of imprisonment on these charges caused, rather than deterred, the alleged attempt. Moreover, this Court will have an opportunity to take that conduct fully into account in imposing sentence in that case.

[19] *See* Letter from Josie C. Dristy, Dep't of the Navy, to Stewart D. Nozette, Notice of Suspension (Nov. 10, 2010) (Ex. O).

attention on cooperating with the government and completing as much of his work as he was able to. He agreed, via his plea, to restore all tax losses, including applicable interest and penalties, to the government, and he has now paid off the entire amount owed. 18 U.S.C. § 3553(a)(2)(A).

Finally, "just punishment for the offense" must take into account other circumstances of Dr. Nozette's life. While they were married, Dr. Nozette's wife, Ms. McColough, was diagnosed with cancer. She survived, but not without sacrifices that required substantial assistance from Dr. Nozette. Her treatment required carefully limiting her exposure to the outdoors and public settings, and Dr. Nozette therefore performed all outdoor errands in the household prior to his incarceration.[20]

Dr. Nozette has also already suffered greatly as a result of these offenses. His previously impeccable personal and professional reputation have been irretrievably tarnished. His family, friends, and co-workers all know what he did. His marriage has collapsed in the wake of his arrest and imprisonment on the attempted espionage charges. His security clearance and permits to access the facilities he works in have been withdrawn. Dr. Nozette's ability to continue his life's work has been destroyed. He is a man with specialized expertise useful mostly to governmental entities; both his ability to earn a living from that expertise and his ability to continue to pursue his lifelong passion for space exploration and technology are now compromised forever.

Even apart from the diminished ability to earn a living after his release from prison, these offenses have already resulted in total financial devastation to Dr. Nozette. The costs of defense in this (and now the other) case have been considerable, and the tax liability he repaid was great.

[20] Indeed, the desire to protect Ms. McColough was a major impetus for Dr. Nozette's plea, through which the government agreed it would not press similar charges against her (which he believed would have been unjustified) and afforded him an opportunity, in the event of successful cooperation, to request a non-custodial sentence.

Dr. Nozette's civil tax liability imposed a 75% penalty on taxes due on unreported income. The penalties, interest, and back taxes paid amounted to $595,057.13—a significant financial cost on Dr. Nozette. This system of penalties and interests is designed to deter and punish those who do not comply with timely tax payments. They amply served their punitive purpose in Dr. Nozette's case; he now has a negative net worth. PSR at ¶ 66. These retributive penalty payments, along with the other facts mentioned here, deserve strong consideration when determining what is a "just punishment" and what sentence is "sufficient, but not greater than necessary" to mete out justice. 18 U.S.C. § 3553, § 3553(a)(2)(A), § 3553(a)(2)(B).

Dr. Nozette has accepted responsibility for his behavior, cooperated with the government in its investigation of him, and provided the government substantial assistance in other investigations. He has accepted responsibility and entered a plea agreement under which he restored to the government all of the losses it suffered under Count Two, in addition to applicable interest and penalties. He has already suffered great financial, professional, and personal losses. Extended incarceration is in his future regardless of the disposition here. The retributive and punitive purposes of sentencing can and will be fulfilled by a more lenient sentence than is called for under the sentencing guidelines.

II. THE COURT SHOULD NOT IMPOSE FINES AS PART OF DR. NOZETTE'S SENTENCE.

Dr. Nozette respectfully submits that the Court should not order fines as part of his sentence, as the PSR is correct to conclude that Dr. Nozette "does not have the ability to pay a fine within the authorized guideline range." PSR at ¶ 71. In determining whether to impose a fine, the Court is required to consider, among other factors, Dr. Nozette's ability to pay in light of earning capacity and financial resources, the burden a fine would place on him and others, any

restitution he has made or will make, and any collateral consequences of conviction, including any civil obligations. 18 U.S.C. § 3572(a); U.S.S.G. §5E1.2(d).

As the PSR shows, Dr. Nozette has only $355.93 in assets, $169,536.05 in liabilities, and zero income, leaving a fine well beyond his means. PSR at ¶ 66. Additionally, his ability to generate income in his chosen field of endeavor has been destroyed, *see supra*; he has already repaid $595,057.13 to the government under the civil settlement resolving Count Two, *see* PSR at ¶ 68; and he will be subject to a restitution order, which we believe should be in the amount of $62,593.01, under Count One.[21] The combined effect on Dr. Nozette's ability to pay a fine is devastating. Dr. Nozette will not profit from his offenses — there is no doubt he has suffered financially, and will continue to suffer, because of them. 18 U.S.C. § 3572(a)(1). A fine is unnecessary to add a financial dimension to Dr. Nozette's punishment: that has already occurred.

III. THE COURT SHOULD ORDER RESTITUTION NOT TO EXCEED $62,593.01 FOR COUNT ONE AND NO RESTITUTION FOR COUNT TWO.

Because loss for the purposes of restitution must be the actual loss the injured party suffered as a result of the defendant's conduct, the Court should order restitution not to exceed $62,593.01. That is the amount left after the government's gross loss of $265,205.57 is offset by the $202,612.56 in legitimate business expenses ACT could have charged to the IPA agreements; this figure, and not the higher figure in the PSR, represents the government's true net loss under Count One. The Court may not order restitution for Count Two, because it is not provided for by statute and because it would unduly delay and complicate the sentencing process.

[21] The government argues that the restitution order should be even greater, $265,205.57.

A. The Court Should Order No More Than $62,593.01 in Restitution for Count One Because the Government's Actual Net Losses Resulting from Dr. Nozette's Conduct Do Not Exceed $62,593.01

The plea documents state that the government's maximum total loss was $265,205.57. *See* Statement of the Offense at 3. This figure was the product of much discussion between the parties. Because Dr. Nozette and his employee performed all the duties required under their contract, they earned their salaries, and none of that money forms part of the government's claimed loss. In addition, the cost accounting required under each contract was minimal, and properly reimbursable benefits typically included any that the home organization provided its employees. Thus, the prosecution recognized as legitimate certain portions of the funds attributed to "fringe benefits" that represented actual employee benefits furnished by ACT to Dr. Nozette and ACT's other employee, although the government never specified precisely which such benefits it credited. For this reason, the $265,205.57 figure is not the aggregate of *all* funds invoiced as benefits throughout the five years. It reflects $66,322 credited against the full amount invoiced as benefits that the prosecution acknowledged were properly chargeable under the IPA contracts.[22]

However, the process of tracing all expenses for these five years and making determinations about their legitimacy as benefits was time-consuming and difficult and would have placed too great a burden on the plea negotiation process were the parties to have insisted upon its completion before reaching agreement. As a result, the Plea Agreement was negotiated to state that the restitution owed under Count One "*should not exceed* $265,205.57." Plea Agreement at 3 (emphasis added). This language reflected the parties' agreement on the $66,322 credit and simultaneously preserved the defense's right to argue that the actual amount should be lower. In fact, it should be substantially lower.

[22] The total benefits figure agreed by the parties during their negotiations for the five year period was $331,526.

When ordering restitution, the court may not order an amount greater than the victim's actual loss. *See Hughey v. U.S.*, 495 U.S. 411, 420 (1990) ("the loss caused by the conduct underlying the offense of conviction establishes the outer limits of a restitution order");[23] *United States v. Smith*, 297 F. Supp. 2d 69, 72-73 (D.D.C. 2003) (requiring "defendants to pay [the victim] an amount above and beyond [its] monetary loss, [is] an outcome that would be in contention with the spirit of the statutes and precedent in this area"); *United States v. Tawil*, 40 Fed. Appx. 531, 535 (9th Cir. 2002) ("restitution is limited to the amount of actual loss to the government due to the crime"). This is because "[t]he focus of a restitution order should be on making victims whole, not on punishing or deterring defendants." *United States v. Bogart*, 490 F. Supp. 2d 885, 901 (S.D. Ohio 2007). As a result, the court must determine what the injured party's actual loss was in order to award restitution. Expected, intended, or risked loss cannot be the basis for a restitution order. *See United States v. Innarelli*, 524 F.3d 286, 295 (1st Cir. 2008) (remanding to the district court for recalculation of restitution and directing that "the amount of restitution ordered must be based on actual loss, not intended or expected loss"); *United States v. Swanson*, 394 F.3d 520, 527 (7th Cir. 2005) ("Unlike a determination of the amount of loss for sentencing purposes, which can include the amount that the defendant placed at risk, a restitution order compensates a victim only for losses it has incurred") (internal citation omitted); *United States v. Anderson*, 85 F. Supp. 2d 1084, 1101 (D. Kan. 1999) ("Unlike other guideline applications, a restitution order cannot be based on the actual or intended gain to the defendant; it must be 'based on the amount of *loss actually caused* by the defendant's offense'" (quoting *United States v. Messner*, 107 F.3d 1448, 1455 (10th Cir. 1997)) (emphasis added)). Nor is the proper amount of restitution controlled by the stipulated loss amount for Count One in the Plea

[23] The restitution statutes discussed in *Hughey* were 18 U.S.C. §§ 3579 and 3580 (1982 Ed.), predecessors to 18 U.S.C. §§ 3363 and 3364.

Agreement of $200,000 to $400,000, *see* Plea Agreement, page 6, paragraph 22, which does not reflect the government's actual net loss. "[T]he appropriate loss amount for purposes of restitution may well be lower than the loss amount for purposes of sentencing. Unlike the calculation of loss amount in sentencing, the purpose of restitution is not to punish the defendant, but to make the victim whole again by restoring to it the value of the losses it suffered as a result of the defendant's crime." *Innarelli*, 524 F.3d at 293.

Here, $265,205.57 is not the amount of the government's actual net loss. Instead, with the exception of the agreed $66,322 credit, it is a gross loss figure based upon the prosecution's calculation of the amount paid by the contracting agencies for personal expenses that were improperly included in fringe benefit amounts in the invoices submitted to those agencies by Dr. Nozette. What it failed to account for are the additional offsetting amounts of fringe benefits that were not included in the invoices but properly could have been. Nor does it account for certain other monies the government owed Dr. Nozette but never paid. Such amounts, which could and should legitimately have been reimbursed under the IPA agreements, must be offset against the gross loss amount to arrive at the figure that represents the actual net loss from the offenses.

First, NASA never paid $18,055.24 from Dr. Nozette's final invoice.[24] This unpaid invoice comprises an undisputed $12,896.60 in salary and $5,158.64 in fringe benefits properly recoverable for work performed by Dr. Nozette.

Second, ACT incurred verifiable expenses of $65,050 in disability insurance,[25] life insurance,[26] and medical expenses[27] that were never invoiced to the government. *See*

---

[24] This was Dr. Nozette's invoice to NASA for the month of February 2006, a duplicate of which is attached hereto as Exhibit P. The NASA investigation had begun at that point, and Dr. Nozette was informed that NASA OIG investigators had directed that payment be withheld. Despite Dr. Nozette reissuing the invoice several times, NASA never paid any of the amount invoiced. Nonetheless, the government's loss calculations assumed that the amounts included in this invoice were paid.

[25] $17,107.

[26] $20,732.

Calculation of Benefits (Ex. Q). All of these were properly chargeable under the ACT IPA agreements. *See* Information at 3, 5, 6.

Third, Dr. Nozette was entitled to earn retirement benefits at 9% of his salary for each year he was an IPA assignee, for a total of $68,453.12. Dr. Nozette's first IPA agreement, with NRL, established this percentage allocation for such benefits, and ACT in fact invoiced 9% of ACT's other employee's ("M.A.") salary for his retirement benefits. *See* NRL IPA (Ex. E) at 3; Sample M.A. Invoice (Ex. R). The retirement benefit amounts collected from the government for ACT's other employee were paid to him in cash-in-lieu-of-retirement. The same cash-in-lieu-of-retirement practice was used for Dr. Nozette, except for 2005 and 2006, when ACT made contributions to a SEP IRA on Dr. Nozette's behalf. All such amounts were properly chargeable against the IPA agreements as bona fide employee benefits.

Fourth, the loss figure must be offset by $78,461.20 in accrued leave benefits for the six years he was under IPA assignment.[28]

Last, the loss figure should be reduced by $38,915. This represents the federal FICA and Medicare taxes (at 6.2% and 1.45% respectively) that ACT would have been legally entitled to

---

[27] $27,211.

[28] Each and every IPA agreement stated that Dr. Nozette was entitled to leave, as determined by ACT policy. *See* NRL IPA (Ex. E) at 2, ¶ 25 ("Leave provisions of ACT will apply. Leave is an ACT fringe benefit"); DARPA IPA (Ex. J) at 2, ¶ 25 ("Leave provisions of Alliance for Competitive Technology will apply"); NASA IPA (Ex. K) at 2, ¶ 25 ("Leave provisions of ACT will apply"). ACT would have been entitled to claim as leave benefits for Dr. Nozette 120 hours of annual leave per year plus eight hours per month of sick leave, which yields a figure of 216 hours of leave accrued per year. This closely approximates the leave Dr. Nozette had earned while employed at Lawrence Livermore National Laboratory ("LLNL"). For LLN's current leave policy, which is similar, see https://careers.llnl.gov/?q=benefits_perks (Ex. S). Dr. Nozette's hourly rate for each year's IPA was multiplied by 216 hour per year. The hourly rate was based on his salary as set forth in the IPA agreements and a billable year of 2,080 hours (annual salary/2080 hours = hourly rate). This "unloaded" hourly rate, which does not include any additional amount for associated fringe benefits or other direct or indirect non-salary costs, is substantially less than the actual hourly rate that would properly be billable under the IPA Agreements. It was used for purposes of this sentencing calculation in an effort to be conservative and avoid the excessive complication that would result from attempting to calculate the proper loaded rate. It should also be noted that Dr. Nozette actually earned more than 216 hours of leave per year because LLNL increases leave accrual per year with seniority, and by the time Dr. Nozette left, he had spent ten years there. Nonetheless, again for the sake of simplicity and out of an abundance of caution, we used the basic figures to calculate his leave due.

recover under the IPA Agreement for 2000 through 2006. The IRS, in the pending resolution of the civil aspects of the tax case, determined that Dr. Nozette was obliged to pay the full amount of the FICA and Medicare taxes for 2001 through 2005 (with interest), and he had already paid them for 2006 when he filed his tax return. A self-employed person bears the full amount of the FICA (social security) and Medicare taxes (at 12.4% and 2.9% respectively), which are termed "self-employment taxes." But an employed person pays half the FICA and Medicare taxes through deductions from his wages, with the other half being an employment-related expense incurred by the employer directly related to the wages paid to the employee. Thus, the employer's half of this tax burden is an expense for which ACT could have legitimately billed the government under the IPA Agreements. And without a corresponding reduction in the restitution due under Count One, it would result in the government being paid twice. Restitution can only make the victim whole, and the offender cannot be held liable in a restitution order for paying the same amount twice. *See United States v. Quillen*, 335 F.3d 219, 222 (3d Cir. 2003) (explaining that the district court may order restitution "provided that the defendant is not required to compensate the victim twice for the same loss"); *United States v. Helmsley*, 941 F.2d 71, 102 (2d Cir. 1991) (same).

These offsets total $268,934.56. The government has already credited Dr. Nozette with $66,322 of that amount (without specifying precisely which of them it agreed with), leaving $202,612.56 which must still be offset from the $265,205.57 maximum gross loss amount. This brings the actual net loss under Count One to $62,593.01.[29] Therefore, the order of restitution under Count One should be in the amount of $62,593.01. Because "an award [of restitution] cannot be woven solely from the gossamer strands of speculation and surmise," *United States v. Vaknin*, 112 F.3d 579, 587 (1st Cir. 1997), the government bears the burden of presenting any

[29] $268,934.56 – $66,322 = $202,612.56 $265,205.57 - $202,612.56 = $62,593.01

alternative calculation of the United States Treasury's loss. *Vaknin*, 112 F.3d at 587 ("The government must bear the burden of establishing the loss").

B. No Restitution Should be Ordered for Count Two Because it is Not Statutorily Authorized and Because it Would Unnecessarily Delay and Complicate the Sentencing Proceedings

The court may not impose restitution under Count Two. Federal courts have authority to order restitution solely pursuant to statute. *See United States v. Anderson*, 545 F.3d 1072, 1077 (D.C. Cir. 2008); *United States v. Bok*, 156 F.3d 157, 166 (2d Cir. 1998). Sections 3663 and 3663A of Title 18 authorize or mandate restitution for certain offenses listed therein. Neither statute encompasses offenses under Title 26 of the United States Code. *See Anderson*, 545 F.3d at 1077; *United States v. Gottesman*, 122 F.3d 150, 151 (2d Cir. 1997).

Section 3663(a)(3) allows a court to order restitution "to the extent agreed to by the parties in the plea agreement." No such agreement exists in the plea document here with respect to Count Two. Instead, Dr. Nozette specifically agreed "to meet with the IRS . . . and agree to assessments for the years 2000 through 2005" and "to undertake to pay all taxes, penalties and interest found to be lawfully owed and due to the Internal Revenue Service for the years 2000 through 2005." Plea Agreement at 3. He has since done this. This civil tax resolution is the means by which the parties agreed that Dr. Nozette would make restitution under Count Two, not through a judicial restitution order in the criminal case.

The Second Circuit's decision in *Gottesman* presented a similar situation, precluding a judicial restitution order as part of the criminal sentence where the defendant had agreed to pay back taxes, interests, and penalties pursuant to negotiations held directly with the IRS. The court recognized that "it is certain that the government anticipated some tax payment by [the defendant]. The only question is whether [the defendant] understood that these reparations could be ordered by a court." *Gottesman*, 122 F.3d at 152. The *Gottesman* court found that §

3663(a)(3) had not been triggered because there, as here, "it was [] apparent that the terms of payment were yet to be negotiated by [the defendant] and the IRS — not imposed by court order." *Id.*; *see also Anderson*, 545 F.3d at 1078 (finding that § 3663(a)(3) had been triggered because "[m]ost important, the conduct of the parties plainly reflects their understanding that the district court had the authority to order restitution to the United States in an amount to be determined by the court"). Dr. Nozette has already paid back taxes, interest, and penalties to the IRS, as he promised in his plea agreement. A further order of restitution on this count would be both unnecessary and impermissible, because "[c]ourt-ordered restitution, with a court-devised payment plan, was not part of the bargain." *Gottesman*, 122 F.3d at 152.

Even if the court retained some discretion to order restitution, it should not do so, if only for the sake of simplicity and to conserve judicial resources. *See* 18 U.S.C. § 3663(a)(1)(B)(ii) ("To the extent that the court determines that the complication and prolongation of the sentencing process resulting from the fashioning of an order of restitution under this section outweighs the need to provide restitution to any victims, the court may decline to make such an order.") Any restitution the court would order under Count Two would necessarily be limited to the government's loss due to the tax evasion. *See Hughey*, 495 U.S. at 420; *Smith*, 297 F. Supp. 2d at 72-73; *Tawil*, 40 Fed. Appx. at 535. Dr. Nozette's tax liability has not been enumerated or proven in this proceeding: it was assessed in the civil tax negotiations pursuant to the plea agreement. Plea Agreement at 3-4. And Dr. Nozette has paid the full agreed amount of back taxes owed, plus applicable interest and penalties — totaling $595,057.13. Because "[r]estitution is in fact and law a payment of unpaid taxes," *United States v. Helmsley*, 941 F.2d 71, 102 (2d Cir. 1991), any restitution the court ordered on Count Two would have to be credited against this $595,057.13 payment in any event. 18 U.S.C. §3664(j)(2)(A) ("Any amount paid to a victim

under an order of restitution shall be reduced by any amount later recovered as compensatory damages for the same loss by the victim in— (A) any Federal civil proceeding"); *see also Helmsley*, 941 F.2d at 102 ("[T]he government may pursue a tax evader for unpaid taxes, penalties and interest in a civil proceeding. However, we believe it is self-evident that any amount paid as restitution for taxes owed must be deducted from any judgment entered for unpaid taxes in such a civil proceeding"). *See* "Notice" from the Office of Chief Counsel, Internal Revenue Service, February 27, 2007 (Ex. T) ("payments of restitution for taxes owed should be credited against the civil liability for unpaid taxes"). In order to make an order of restitution, the court would need to undertake its own calculation — a complex and painstaking process that would be pointless and unnecessary in light of the civil settlement that Dr. Nozette has already reached and satisfied.

As a result, Dr. Nozette respectfully submits that no restitution should be awarded on Count Two, and the appropriate restitution order is the amount owed on Count One: $62,593.01.

IV. THE COURT SHOULD SET A SCHEDULE OF PERIODIC NOMINAL RESTITUTION PAYMENTS THAT ACCOUNTS FOR DR. NOZETTE'S LACK OF FINANCIAL RESOURCES.

In setting the schedule and amount of restitution payments, the Court must consider Dr. Nozette's current financial circumstances. 18 U.S.C. § 3664(f)(2). If his finances "do not allow the payment of any amount of a restitution order, and do not allow for the payment of the full amount of a restitution order in the foreseeable future under any reasonable schedule of payments," then the Court should order only "nominal periodic payments." § 3664(f)(3)(B); *see also United States v. Lewis*, Crim. No. 09–213, 2011 WL 2413156, at *14 (D.D.C. June 13, 2011) (ordering nominal periodic payments where defendant had minimal assets, $1,870 in unpaid bills, and gross income of $7,343 for prior year). A restitution order that does not reflect Dr. Nozette's inability to pay constitutes error. *See United States v. Short*, 25 F. App'x 100, 103-

04 (4th Cir. 2001) (remanding where "district court made no findings as to whether [defendant's] economic situation makes him a candidate for restitution via 'nominal periodic payments' pursuant to § 3664(f)(3)(B)"); *United States v. Myers*, 198 F.3d 160, 168-69 (5th Cir. 1999) (holding that district court "plainly erred in requiring immediate payment of the restitution" when defendant had negative net worth and no income).

As the PSR demonstrates, Dr. Nozette lacks the resources to pay restitution. The significant payments he has already made to the government, his substantial debt and resulting negative net worth, his current and future incarceration, and his diminished job prospects leave him simply unable to pay any amount in the foreseeable future. The Court should therefore order a schedule of nominal periodic payments, to commence after Dr. Nozette is released from custody and has the opportunity to obtain employment. *See United States v. Matz*, Crim. No. 04-61, 2009 WL 2777693, at *2 (W.D. Wis. Aug. 28, 2009) (nominal restitution payments to begin "within 30 days of [defendant's] release from custody"); *United States v. Lenihan*, Crim. No. 08-2017, 2009 WL 1767064, at *5 (E.D. Wash. June 18, 2009) (restitution payments to begin "within 90 days of [defendant's] release from custody"); *United States v. Robinson*, Crim. No. 97–112, 1997 WL 602801, at *3 (E.D. Pa. Sept. 23, 1997) (restitution payments "not [to] commence until the defendant is released from prison"); *see also United States v. Dubose*, 146 F.3d 1141, 1147 (9th Cir. 1998) (affirming district court's order that defendants pay $5 per month while incarcerated and $25 per month for twenty years after their release).

In setting a payment schedule, the Court must consider Dr. Nozette's: (A) "financial resources and other assets" (whether jointly or individually controlled), (B) "projected earnings and other income," and (C) "any financial obligations." 18 U.S.C. § 3664(f)(2)(A)-(C).[30] By

[30] The reviewing court should be able to "discern from the record that this consideration has taken place." *United States v. Ahidley*, 486 F.3d 1184, 1191 (10th Cir. 2007); *see also United States v. Lucien*, 347 F.3d 45, 53-54 (2d

statute, the PSR serves as the chief source for that information. *See* 18 U.S.C. § 3664(a) (requiring court to order production of PSR containing "information sufficient for the court to exercise its discretion in fashioning a restitution order"). Indeed, reviewing courts have found error where the sentencing court's restitution order was inconsistent with the PSR's findings, and not otherwise supported. *See, e.g.*, *United States v. Chino*, 331 F. App'x 592, 599 (10th Cir. 2009) (finding plain error where restitution order was inconsistent with record, including PSR finding that defendant was indigent); *United States v. Mammedov*, 304 F. App'x 922, 927-28 (2d Cir. 2008) (vacating restitution order that was inconsistent with PSR, which district court had adopted as its findings); *United States v. Karam,* 201 F.3d 320, 330 (4th Cir. 2000) (finding district court's adoption of PSR that contained sufficient facts to support restitution order avoided plain error). *Mammedov* is a typical case. There, the district court adopted the PSR's findings regarding Mammedov's lack of assets and declined to impose a fine because of his inability to pay it. *Mammedov*, 304 F. App'x at 927-28. Nevertheless, the district court required repayment to begin right away for "symbolic" reasons. *Id.* at 928. The court of appeals deemed this "an abuse of discretion that constitute[d] plain error." *Id.*

Here, the PSR reveals that Dr. Nozette—far from having assets and earnings available for restitution—is deeply in debt. On each of the three statutory factors, the PSR demonstrates that Dr. Nozette is unable to pay more than nominal restitution. First, he has zero cash and only a few securities for total assets of $355.93. PSR at ¶ 66. This lack of resources is due to his payment of the $595,057.13 in taxes, penalties, and interest owed to the government under the civil settlement resolving Count Two. *See* PSR at ¶¶ 68-69. His ex-wife, Ms. McColough, reported that she "sold and liquidated *all* [Dr. Nozette's] assets to pay their outstanding debt."

Cir. 2003) ("[T]he record must disclose some affirmative act or statement allowing an inference that the district court in fact considered the defendant's ability to pay." (internal quotations omitted)).

PSR at ¶ 69 (emphasis added). This includes the sale of their home in Chevy Chase, Maryland in July 2010, the proceeds of which were used to repay $325,160.74, and the sale of their home in Merritt Island, Florida, which paid off a $2,170.00 federal tax lien. As a result, the debt to the government is now fully settled. *See* Letter from D. Greenstein, Revenue Officer, IRS, to Burton J. Haynes, Notice of Case Resolution (Aug. 3, 2010) (Ex. N).

Second, concerning projected income and earnings, the PSR indicates that Dr. Nozette currently has zero monthly income, PSR at ¶ 66, which is likely to continue for the remaining years of his incarceration. *See United States v. Day*, 418 F.3d 746, 761 (7th Cir. 2005) (vacating restitution order and inviting district court to consider ordering nominal payments in part because, "in light of [defendant's] current incarceration . . . , it is likely that his financial situation will only decline"). Even after his release, it is unlikely that Dr. Nozette will be able to earn a living in his professional field. *See United States v. Lenihan*, Crim. No. 08-2017, 2009 WL 1767064, at *5 (E.D. Wash. June 18, 2009) (imposing limited restitution payments because "[defendant's] conviction stigmatizes him and the conditions of his supervised release will be burdensome" and "[i]t will likely be some time before he can regain an earning capacity that allows any significant discretionary spending"). Finally, Dr. Nozette's current liabilities amount to $169,536.05, leaving him with a negative net worth of $169,180.12. PSR at ¶ 66.

Based on Dr. Nozette's financial condition, the PSR concluded that he "does not have the ability to pay a fine within the authorized guideline range," which the PSR indicated, contrary to our position, was $6,000 to $60,000.[31] PSR at ¶ 71. When a defendant cannot afford to pay a fine, a restitution order that imposes more than nominal payments is inappropriate. *See*

[31] The PSR based this conclusion in part, on "the amount of restitution" Dr. Nozette would owe, but the report set forth only the total amount of restitution owed and did not specifically recommend a schedule or amount of individual payments. In fact, the PSR explicitly suggested the possibility of periodic nominal payments based on Dr. Nozette's economic circumstances. PSR ¶ 91.

Mammedov, 304 F. App'x at 927-28 (vacating restitution order where order was inconsistent with court's findings, including defendant's inability to pay a fine); *United States v. Dungee*, 228 F. App'x 298 (4th Cir. 2007) (finding error where district court did not link restitution schedule to financial condition and questioning court's decision not to "adopt the presentence report, which discussed [defendant's] financial condition and inability to pay a fine"); *United States v. Ahidley*, 486 F.3d 1184, 1193-94 (10th Cir. 2007) (vacating restitution order and stating that "district court appeared to acknowledge [defendant's] impecunious state by waiving imposition of the fine. On these facts, it would appear almost beyond question that defendant could not make an immediate, single lump-sum payment of over $22,500"). Given that the PSR concluded that Dr. Nozette cannot afford to pay even the minimum fine of $6,000, he should not be subjected to any more than nominal restitution payments.

CONCLUSION

Dr. Nozette respectfully requests that the Court depart from the sentencing guidelines range and show him maximum leniency with respect to incarceration, decline to order a monetary fine, and order restitution on Count One in the amount of $62,593.01, to be paid in nominal periodic amounts following his release from prison.

Dated: March 12, 2012

Respectfully submitted,

/s/ Bradford A. Berenson
Bradford A. Berenson
D.C. Bar No. 441981
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, D.C. 20005
Telephone: (202) 736-8000
Fax: (202) 736-8711
Email: bberenson@sidley.com

Attorney for Defendant Stewart D. Nozette

CERTIFICATE OF SERVICE

I hereby certify that on this 12th day of March, 2012, I caused to be served by email a true and correct copy of the foregoing DEFENDANT'S SENTENCING MEMORANDUM to each of the following at the addresses listed:

Michael K. Atkinson
Michael.Atkinson2@usdoj.gov
Assistant United States Attorney
Fraud and Public Corruption Section
555 4th Street, N.W.
Washington, D.C. 20530