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## A Judicious Solution: The Criminal Law Committee Draft Redefinition of the Loss Concept in Economic Crime Sentencing

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A JUDICIOUS SOLUTION: THE CRIMINAL LAW  
COMMITTEE DRAFT REDEFINITION OF THE "LOSS"  
CONCEPT IN ECONOMIC CRIME SENTENCING

*Frank O. Bowman, III\**

INTRODUCTION

In December 1999, the United States Sentencing Commission (Commission), an institution that had been in suspended animation for over a year with all seven voting seats vacant, fluttered its eyelids and came back to life. An agreement between the Senate and the White House produced seven new Commissioners: five sitting federal judges, the former General Counsel of the Commission, and a law professor. The new group began work immediately, making itself accessible in meetings with lawyers and judges around the country, exuding an air of intelligence and collegiality, and dispensing in short order with a backlog of amendments to the United States Sentencing Guidelines (Guidelines) mandated by Congress.<sup>1</sup> Having cleared away most of the housekeeping chores that had piled up during its long sleep, the Commission recently turned to issues of broader scope.

The first major undertaking of the newly-appointed Commission has been a reexamination of economic crime sentencing. In choosing economic crime sentencing reform as its initial large project, the new Commission elected to build on a foundation laid by its immediate predecessors. Staff work on economic crime sentencing reform began in 1995.<sup>2</sup> In January 1997, the Commission promulgated issues for comment on economic crime sentencing reform<sup>3</sup> and held public hearings in 1997 and

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<sup>1</sup> U.S. SENTENCING GUIDELINES MANUAL, app. C, amends. 590-607 (2000) [hereinafter U.S.S.G.].

<sup>2</sup> See, e.g., Memorandum of Frank O. Bowman, III, Special Counsel, U.S. Sentencing Commission, to Donald A. Purdy, Chief Deputy General Counsel, U.S. Sentencing Commission, Summary and Analysis of Judicial Interpretations of the Term "Loss" in U.S.S.G. §§ 2B1.1 and 2F1.1, Apr. 16, 1996 (on file with author).

<sup>3</sup> Federal Register Notice BAC2210-40, 62 Fed. Reg. 152, 171-74 (1997).

1998.<sup>4</sup> In January 1998, the Commission published for comment a comprehensive economic crime reform package that would have consolidated the theft and fraud guidelines, revised the loss table at the heart of both guidelines, and redefined the exasperating, but pivotal, term “loss.”<sup>5</sup> In April 1998, a revised version of the package came within one vote of obtaining the unanimous approval it required. Unfortunately, no further formal action was possible in 1998-99 because, by the fall of 1998, the terms of all the Commissioners had expired and the vacancies remained unfilled until December 1999.

At the core of the last Commission’s economic crime package lay the redefinition of the concept of ‘loss.’ The amount of loss inflicted by a convicted criminal is a primary determinant of sentence length for economic crimes. Yet, as will be discussed below, the current Guidelines provisions regarding the meaning of loss are a confusing patchwork. Reconsideration of the loss definition was so plainly essential to any meaningful economic crime sentencing initiative that, even after it became clear that they themselves would be unable to bring reform to fruition, the last Commission arranged for the loss redefinition so nearly passed in April 1998 to be field tested during the summer of 1998.<sup>6</sup> The response to the proposed redefinition by the federal judges and probation officers who participated in the field test was overwhelmingly positive.<sup>7</sup> Consequently, even during the 1998-99 hiatus with no sitting Commissioners, Commission staff, in consultation with interested outside groups, continued to work on refining the draft definition, with particular attention to feedback received during the field test.<sup>8</sup>

The Committee on Criminal Law of the United States Judicial Conference (CLC) has been an interested and active participant throughout the Commission’s consideration of economic crime sentencing reform.<sup>9</sup> In

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<sup>4</sup> In October 1997 and again in March 1998, the Commission held public hearings on proposals to reform economic crime sentencing. (Transcripts of the hearings and copies of the written statements of the witnesses in these hearings can be obtained at the Commission website, <http://www.uscc.gov>.) For a discussion of the status of the evolving debate on economic crime sentencing reform as it existed in early 1998, see Frank O. Bowman, III, *Back To Basics: Helping the Commission Solve the “Loss” Mess With Old Familiar Tools*, 10 FED. SENT. REP. 115 (Nov./Dec. 1997).

<sup>5</sup> 63 Fed. Reg. 602, 602-09 (Jan. 6, 1998).

<sup>6</sup> See *A Field Test of Proposed Revisions to the Definition of Loss in the Theft and Fraud Guidelines: A Report to the Commission*, Oct. 20, 1998 available at <http://www.uscc.gov/pdf/lossdefn/pdf> (hereinafter *Field Test*).

<sup>7</sup> *Id.*

<sup>8</sup> An Economic Crimes Working Group from the Sentencing Commission staff, in consultation with outside groups such as the U.S. Judicial Conference, the Department of Justice, and the Practitioners Advisory Group, continued to refine the April 1998 proposal. The staff produced a proposal for a revised definition in May 1999. See *Proposed Loss Definition May 1999* [hereinafter *May 1999 Draft*] (on file with author). During 1999, work also continued on possible revisions of the loss table.

<sup>9</sup> Representatives of the CLC testified at Commission hearings and were heavily involved in negotiations over the shape of the package formally presented to the Sentencing Commission in April

order to assist the Commission in its deliberations, the CLC drafted and, on November 9, 2000, submitted to the Commission its own economic crime sentencing reform proposal for publication for comment.<sup>10</sup> The CLC has built upon and refined the approach so nearly adopted in 1998. The judges recommend: (1) that the theft and fraud Guidelines be consolidated; (2) that the loss table be simplified by reducing the number of its levels and modified by decreasing sentences for some low-loss offenders while increasing sentences for some high-loss offenders; and (3) that loss be redefined. More importantly, the CLC has gone beyond general recommendations and transmitted to the Commission a specific proposal for a new loss table and draft language for a redefinition of loss. (The CLC draft of a reformed loss definition appears following this Article as Appendix A.)

The purpose of this Article is three-fold. First, it explains the need for consolidation of the theft and fraud guidelines and for a revised definition of loss. Second, it introduces the CLC's proposed loss definition and explains, in detail, the reasoning behind the drafting choices made by the judges of the CLC when preparing this proposed new definition. Third, where appropriate, it addresses differences between the CLC proposal and other draft definitions that have been put forward by Commission staff and other participants in the reform process, with particular attention to the field-tested April 1998 draft and the most recent staff draft published in January 2001 (2001 Staff Draft).<sup>11</sup> This Article does not discuss the CLC proposal regarding the loss table.<sup>12</sup>

## I. THE CASE FOR REFORM

Between one-fifth and one-quarter of all convicted federal defendants are sentenced for some kind of economic crime.<sup>13</sup> When the original

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1998. See, e.g., *U.S. Sentencing Commission October 1997 Hearing on the Definition of "Loss": Excerpts*, 10 FED. SENT. REP. 157 (1997) (testimony of Hon. Gerald Rosen before Commission on behalf of the CLC); J. Phil Gilbert, *Statement on Loss on Behalf of the Judicial Conference Committee on Criminal Law*, 10 FED. SENT. REP. 128 (1997) (statement by then-Chair of CLC Sentencing Guidelines Subcommittee endorsing a common definition of loss in both theft and fraud cases).

<sup>10</sup> See Letter of Hon. William W. Wilkins, Jr., Chair, Committee on Criminal Law of the Judicial Conference of the United States, to the Chair and Members of the U.S. Sentencing Commission (with attachments), Nov. 9, 2000 (on file with author). The Commission voted to publish the CLC proposal for comment in the Federal Register. See Federal Register Notice BAC2210-40/2211-01 available at <http://www.uscc.gov/FEDREG/fedr0101.htm>. That portion of the CLC proposal addressing redefinition of "loss" is reproduced as Appendix A to this Article.

<sup>11</sup> Federal Register Notice BAC2210-40/2211-01, Amendment 12C, Option One (Commission Proposal), available at <http://www.uscc.gov/FEDREG/fedr0101.htm> (hereinafter *2001 Staff Draft*).

<sup>12</sup> The rationale behind the CLC table proposal is explained by Catharine Goodwin elsewhere in this issue. See Catharine Goodwin, *Reconsideration of the Economic "Loss" Tables: Time for Meaningful Reform*, 9 GEO. MASON L. REV. 391 (2001).

<sup>13</sup> In 1999, 22.6% of federal criminal defendants were sentenced for fraud, larceny, embezzlement, auto theft, robbery, burglary, forgery, or counterfeiting. 1999 SOURCEBOOK OF FEDERAL

Commission wrote guidelines for economic crimes 1987, it made the idea of loss the linchpin of the enterprise.<sup>14</sup> The Commission wrote separate guidelines for theft and fraud cases. However, in both guidelines the base offense level<sup>15</sup> resulting from conviction alone is very low (four in theft cases,<sup>16</sup> and six in fraud cases<sup>17</sup>), while the offense level can increase by up to eighteen levels depending on the amount of loss found by the court.<sup>18</sup> More concretely, the maximum term of imprisonment a judge could impose on a first-time fraud offender based on the fact of conviction alone would be six months,<sup>19</sup> but that sentence could increase to more than five years based solely on the amount of loss.<sup>20</sup>

Of course, loss amount is far from the only factor affecting sentence length in economic crimes. A defendant's sentence can be adjusted as a result of judicial findings on matters such as the defendant's role in the offense,<sup>21</sup> his abuse of trust or misuse of a special skill,<sup>22</sup> whether he engaged in more than minimal planning or stole from more than one victim,<sup>23</sup> whether the victim was particularly vulnerable,<sup>24</sup> whether the offense was committed using mass marketing techniques<sup>25</sup> or sophisticated means,<sup>26</sup> or whether the crime jeopardized the safety or soundness of a financial insti-

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SENTENCING STATISTICS 12, tbl. 3 (2000) (hereinafter 1999 SOURCEBOOK). The percentage of economic crimes as a proportion of all federal offenses has declined slightly in the last few years, although the absolute number of such offenses has increased. For example, in fiscal year 1995, 26.36% of the federal sentences imposed were for auto theft, larceny, fraud, embezzlement, forgery, or counterfeiting. U.S. Sentencing Commission, *Annual Report 1995* 60, tbl. 18 (1996) (hereinafter *1995 Annual Report*).

<sup>14</sup> For an explanation of the operation of the Guidelines generally, and the guidelines on economic crimes in particular, see Frank O. Bowman, III, *Coping With "Loss": A Re-Examination of Sentencing Federal Economic Crimes Under the Guidelines*, 51 VAND. L. REV. 461, 472-90 (1998).

<sup>15</sup> The Guidelines measure offense seriousness on the vertical axis of a sentencing grid. U.S.S.G. § 5A (2000). The unit of measurement on this axis is an "offense level." The "base offense level" for a crime is the number of offense levels awarded simply for conviction of the basic crime covered by the particular guideline in question. A defendant's final offense level will be the product of a process of adding to or subtracting from the base offense level as a result of other factors present in the offense. In economic crimes, one of the principal such factors is the amount of loss. For a further explanation, see Bowman, *supra* note 14.

<sup>16</sup> U.S.S.G. § 2B1.1(a)(2000).

<sup>17</sup> U.S.S.G. § 2F1.1(a).

<sup>18</sup> U.S.S.G. §§ 2B1.1(b)(1)(A-U), 2F1.1(b)(1)(A-S).

<sup>19</sup> U.S.S.G. § 5A (Sentencing Table).

<sup>20</sup> U.S.S.G. §§ 2F1.1(b), 5A. The increase in maximum available sentence from six months to five years posited in the text assumes a first-time offender convicted of fraud with a resulting base offense level of six who stole \$80 million, the maximum amount on the loss table. It also assumes no other adjustments to offense level other than that for loss amount.

<sup>21</sup> U.S.S.G. §§ 3B1.1, 3B1.2 (providing two to four level increases or decreases in offense level based on judicial findings that a defendant played an aggravating or mitigating role in the offense).

<sup>22</sup> U.S.S.G. § 3B1.3.

<sup>23</sup> U.S.S.G. § 2F1.1(b)(2).

<sup>24</sup> U.S.S.G. § 3A1.1(b)(1).

<sup>25</sup> U.S.S.G. § 2F1.1(b)(3).

<sup>26</sup> U.S.S.G. § 2F1.1(b)(6).

tution.<sup>27</sup> Because of the logarithmic structure of the sentencing table, in which every increase of two offense levels represents a twenty-five percent increase in sentencing range, factors other than loss may have an even greater percentage impact on sentence length than loss amount.<sup>28</sup> Nonetheless, the loss calculation is a constant in all theft and fraud cases and sets the platform on which other sentence adjustments build.

In the years since the Guidelines were adopted, the loss calculation has become one of the most commonly litigated issues in federal sentencing law. Because the loss measurement is a primary determinant of sentence length in all crimes of dishonest acquisition, federal district court judges must make loss findings in more than 9,000 cases every year.<sup>29</sup> There are more than twelve hundred reported federal court opinions that discuss the loss finding in some way.<sup>30</sup> In addition to the sheer number of opinions on loss, disputes over the meaning of the term have produced numerous splits of opinion between the federal circuits.<sup>31</sup> Perhaps even more significant than either the volume of litigation or the number of identifiable circuit splits is the overall sense of uncertainty, confusion, and sheer aggravation that emerges whenever lawyers and judges who deal with federal white-collar crime discuss loss.<sup>32</sup> As but one example, in

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<sup>27</sup> U.S.S.G. § 2F1.1(b)(8)(A).

<sup>28</sup> Assume, for example, a fraud defendant whose scheme caused a loss of \$400,000. Under section 2F1.1(a-b), his base offense level would be six, to which would be added nine levels for amount of loss. Without more, the resulting offense level of fifteen would produce (for a first-time offender) a sentencing range of eighteen to twenty-four months. If the defendant was the leader of a group with five or more participants (§ 3B1.1(a)), that used mass marketing techniques (§ 2F1.1(b)(3)) to defraud more than one victim (§ 2F1.1(b)(2)(A)), he would receive an additional eight-level upward adjustment. This adjustment would place the defendant at offense level twenty-three, for which the sentencing range is forty-six to fifty-seven months, more than doubling the sentence the defendant would have received based on loss amount alone. U.S.S.G. § 5A.

<sup>29</sup> Loss calculations are required in all fraud, larceny, and embezzlement cases. U.S.S.G. §§ 2B1.1, 2F1.1. In 1999, federal judges sentenced 6,144 fraud defendants, 2,067 larceny defendants, 949 embezzlement defendants. 1999 SOURCEBOOK, *supra* note 13, at 24, tbl. 11. In addition, loss calculations are often necessary in burglary and robbery cases, U.S.S.G. §§ 2B2.1, 2B3.1. In 1999, federal courts sentenced 1,771 robbery defendants, and fifty-three burglary defendants. U.S.S.G. §§ 2B2.1, 2B3.1. Thus, somewhere between 9,000 and 11,000, or sixteen to twenty percent, of the 54,903 federal cases sentenced in 1999 required a determination of loss. This proportion has held roughly steady for some years. *See, e.g., 1995 Annual Report, supra* note 13, at 60, tbl. 18.

<sup>30</sup> For example, a Westlaw search conducted on November 11, 2000 revealed over 1,200 federal cases in which loss under Guideline sections 2B1.1 or 2F1.1 is at least mentioned. As of the same date, there were at least 300 officially reported federal appellate decisions under section 2F1.1 alone in which the amount of loss was an issue of sufficient moment that the opinion discussed it in detail. ROGER W. HAINES, JR. & JENNIFER WOLL, FEDERAL SENTENCING GUIDE § 305 (CD-Rom Edition 2000). The Federal Sentencing Guide provides one paragraph summaries of significant sentencing issues decided in published opinions by federal courts of appeals. It does not summarize sentencing decisions in district court cases or in unpublished, though publicly available, appellate opinions.

<sup>31</sup> *See* Bowman, *supra* note 14, at 464 n.3.

<sup>32</sup> *See United States v. Kaczmariski*, 939 F. Supp. 1176, 1182 n.7 (E.D. Pa. 1996), *aff'd*, 114 F.3d 1173 (3d Cir. 1997), in which Judge Dalzell refers with obvious exasperation to the task of construing the vaporous word loss. The Second Circuit describes loss more circumspetly as a flexible, fact-

1996, a Federal Judicial Center survey of judges and probation officers found that both groups ranked the loss definition as the second most pressing issue for the Commission to address.<sup>33</sup>

### A. Consolidation of the Theft and Fraud Guidelines

The source of some of the confusion surrounding federal economic crime sentencing generally, and the loss concept in particular, is the existence of one Guideline for crimes involving theft, section 2B1.1, and another for crimes involving fraud, section 2F1.1. There is no good reason to have two separate Guidelines for theft and fraud. There are compelling reasons to consolidate sections 2B1.1 and 2F1.1.

First, the distinction between theft and fraud is largely illusory. Although not all theft crimes are frauds, virtually every fraud could be charged as some form of theft. Federal law abounds with instances where the same course of thievery is chargeable under multiple statutes, some of which are called frauds, and some of which are traditional theft-like offenses.<sup>34</sup> Second, even if it were possible to draw a meaningful distinction between thefts and frauds, it would only be useful to do so in writing sentencing guidelines if the objective were to generate different sentencing outcomes for the two categories of cases. However, the sentencing range under both the theft and fraud guidelines is driven almost entirely by loss amount, and the loss tables in the two guidelines are virtually identical. Therefore, unless the term loss means something different in theft and fraud cases, application of either section 2B1.1 or section 2F1.1 to the same set of facts will customarily produce either the identical sentencing range, or a pair of ranges so close that the top of one will approach, or even overlap, the bottom of the other.<sup>35</sup> Because the fraud Guideline essentially adopts the loss definition from the theft Guideline, this is exactly what happens. Thus, in the overwhelming majority of cases, the existence of separate fraud and theft Guidelines is merely a pointless duplication.

Third, the existence of separate theft and fraud Guidelines is mischievous. Sections 2B1.1 and 2F1.1, and their respective commentaries regarding loss, are *slightly* different, albeit for reasons that are not easy to discern. Consequently, creative litigants and judges try to impute meaning into the differences, which only leads to confusion.<sup>36</sup>

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driven concept. *United States v. Jacobs*, 117 F.3d 82, 95 (2d Cir. 1997).

<sup>33</sup> Federal Judicial Center 1996 Survey on Sentencing Guidelines (1997).

<sup>34</sup> See Bowman, *supra* note 14, at 490-92 (discussing the illusory character of the theft-fraud distinction in federal law).

<sup>35</sup> The Sentencing Table is constructed so that the top of one sentencing range will overlap the bottom of the range two offense levels higher. U.S.S.G. ch. 5, pt. A (2000).

<sup>36</sup> See the series of Third Circuit cases beginning with *United States v. Kopp*, 951 F.2d 521 (3d Cir. 1991), running through *United States v. Badaracco*, 954 F.2d (3d Cir. 1992), *United States v.*

There now appears to be little or no dissent from the view that the theft and fraud guidelines should be consolidated. A consolidated economic crimes guideline was part of the former Commission's economic crime package.<sup>37</sup> The CLC has supported consolidation since 1997.<sup>38</sup> Probation officers would welcome it,<sup>39</sup> and neither the Justice Department nor the Practitioners Advisory Group (the official advisory body representing the defense bar in Commission matters) has expressed opposition to the principle of consolidation.

### B. *The Loss Conundrum*

Sadly, the apparent consensus on consolidating sections 2B1.1 and 2F1.1 brings us no closer to penetrating the central mystery of federal economic crime sentencing—the conundrum of loss. Why is loss such a problem? No one disputes the notion that stealing more is worse than stealing less. Similarly, almost no one disagrees with the basic judgment at the heart of the current economic crime guidelines that the sentences of thieves and swindlers should be determined in some significant part by the magnitude of the economic deprivations they caused or intended.<sup>40</sup> Where the Commission has fallen short is in the translation of a sound fundamental intuition into a just, doctrinally coherent, easy-to-apply set of rules.

The root of the loss problem is that the Guidelines do not now contain a meaningful definition of the term. The descriptive commentary regarding loss following sections 2B1.1 and 2F1.1 includes a series of directives which neither singly nor together amount to a coherent definition. (The various sections of Guidelines commentary addressing loss from sections 2B1.1 and 2F1.1 of the current Guidelines are drawn together in Appendix B to this Article.) The basic definition of loss announced in the theft guideline<sup>41</sup> and adopted by reference into the fraud guideline<sup>42</sup>—“the value of the property taken, damaged, or destroyed”—uses the language of larceny. The word ‘taken’ is a term of art, denoting to any Anglo-American

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*Coyle*, 63 F.3d 1239 (3d Cir. 1995), and *United States v. Maurello*, 76 F.3d 1304 (1996).

<sup>37</sup> 63 Fed. Reg., No. 3, Pt. II (Jan. 6, 1998).

<sup>38</sup> See Gilbert, *supra* note 9 (statement by then-Chair of CLC Sentencing Guidelines Subcommittee endorsing a common definition of loss in both theft and fraud cases).

<sup>39</sup> Fred S. Tryles, *A Critique of the Operation of the Theft and Fraud Guidelines from the Perspective of One Probation Officer*, 10 FED. SENT. REP. 131 (1997).

<sup>40</sup> There is, however, disagreement over the degree to which numeric measurements of economic harm should drive economic crime sentences. At the symposium from which this issue of the *George Mason Law Review* took its genesis, Senior Judge Jon Newman of the United States Court of Appeals for the Second Circuit gave voice to the view of a number of conference participants that the influence of loss amount on sentence length should be substantially decreased. Judge Newman has since embodied his argument in an article. Jon O. Newman, *Toward Guidelines Simplification*, 13 FED. SENT. REP. \_\_ (2000) (forthcoming).

<sup>41</sup> U.S.S.G. § 2B1.1, app. note 2 (2000).

<sup>42</sup> U.S.S.G. § 2F1.1, app. note 8 (2000).



criminal lawyer the “taking” element of common law larceny, with its insistence on a transfer of possession of moveable personalty.<sup>43</sup> Outside the limited context of simple larceny-like offenses, this definition is virtually useless. For example, if ‘taken’ retains some vestige of its common law meaning, when is property ‘taken’ in a wire fraud or a check kite or a bankruptcy fraud or an insider trading case? And how? And from whom? Alternatively, if ‘taken’ is intended to invoke no particular doctrinal association, what does it mean?

Aside from the larceny-based core definition, perhaps the most glaring defect in the current loss rules is their treatment of causation. When we ask what the loss is in any particular case, we are really asking two questions about causation: First, what economic harms resulted from defendant’s conduct? Second, which among the harms the defendant caused in fact should count in law in setting his sentence? The guidelines relating to these questions and the cases construing them have created a puzzling patchwork, which so far as can be discerned, looks roughly like this:

1. The relevant conduct guideline, section 1B1.3, mandates a broad measurement of harm, saying that offense levels are to be determined based on “all harms resulting from” a defendant’s own conduct, and thus apparently sets up a rule of pure ‘but for’ causation.<sup>44</sup>

2. By contrast, both the fraud and theft guidelines define loss narrowly as the ‘thing taken,’ the *corpus delicti* of the crime.<sup>45</sup>

3. Moreover, section 2F1.1, Application Note 8(c), says only ‘direct damages’ count, and excludes ‘consequential damages.’ Both these terms are drawn from contract law and are difficult, if not impossible, to apply in the criminal context.<sup>46</sup> If ‘consequential damages’ is given its customary contract law meaning, Note 8(c) excludes from loss even economic harms which are directly caused by defendant’s conduct and foreseeable by him.<sup>47</sup>

4. On the other hand, in cases of procurement fraud and product substitution, section 2F1.1, Application Note 8(c), specifically includes in loss

<sup>43</sup> See JOSHUA DRESSLER, UNDERSTANDING CRIMINAL LAW § 32.04, at 510 (2d ed. 1995).

<sup>44</sup> U.S.S.G. § 1B1.3 (2000).

<sup>45</sup> U.S.S.G. §§ 2B1.1, n.2, 2F1.1, n.8 (2000).

<sup>46</sup> For a complete discussion of the problems created by the importation into the Guidelines of the contract terms “direct damages” and “consequential damages,” see Bowman, *Coping With “Loss,”* *supra* note 14, at 511-22.

<sup>47</sup> The modern test for whether some alleged economic harm caused by a breach of contract is classified as a “consequential damage” is whether the harm was reasonably foreseeable to the breaching party. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 10-4 (Damages for Breach of Warranty Consequential Damages) 564 (4th ed. 1995), A. CORBIN, CORBIN ON CONTRACTS §1010, at 79 (1964); see also U.C.C. § 2-715(2) (1995) (stating that a defendant would be liable for “any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know.”) If a harm to a contract plaintiff was reasonably foreseeable to the breaching defendant, then it is ordinarily recoverable by the plaintiff absent some special contractual provision excluding such recovery. U.C.C. § 2-715, cmt. 3 (1995).

the ‘consequential damages’ elsewhere excluded, if the loss is ‘foreseeable.’<sup>48</sup>

5. Likewise, under the relevant conduct rules, section 1B1.3, if a defendant has co-conspirators or other criminal cohorts, he is responsible for all harms that resulted from all of their “reasonably foreseeable acts and omissions” in furtherance of the crime.<sup>49</sup>

6. In loan fraud cases, pursuant to section 2F1.1, Application Note 8(b), the loss to banks caused by a drop in value of pledged collateral is a part of the loss, regardless of whether it was foreseeable and despite the fact that such a loss is a classic ‘consequential damage.’<sup>50</sup>

7. Except in loan fraud cases, if a victim’s loss is genuinely attributable to several causes, there is no rule for determining what the causal nexus to a defendant’s conduct must be before the loss should be counted.

This patchwork of causation describes only some of the problems with measuring losses actually incurred, and deals not at all with the oddities of the Guidelines’ treatment of loss in wholly or partially completed offenses.

In short, in place of a coherent definition of a concept central to the sentencing of more than one-fifth of all federal defendants,<sup>51</sup> the Guidelines present us with a jumble of rules about what loss means in particular situations. This jumble developed piecemeal over the first decade of Guideline experience, with issues addressed as they were encountered. Until recently, there was no occasion for a comprehensive review of the issues presented by the loss cases, nor an initiative to mold the insights gained from experience into a coherent whole that attempted to account for how the loss concept fits into a scheme of punishment for economic crime. In the absence of clearly articulated central organizing principles, it is hardly surprising that the various rules announced over time do not mesh very well. Given that the Guidelines do not presently contain a coherent, workable definition of loss, how should loss be defined?

## II. EXPLAINING THE CRIMINAL LAW COMMITTEE’S DRAFT DEFINITION OF ‘LOSS’

Any effort to redefine loss risks replicating earlier mistakes if those involved in the process fail to identify core principles, or having identified such principles, fail to adhere to them in drafting particular rules. Con-

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<sup>48</sup> U.S.S.G. § 2F1.1 n.8(c) (2000).

<sup>49</sup> U.S.S.G. § 1B1.3 (2000).

<sup>50</sup> U.S.S.G. § 2F1.1 n.8(b) (2000).

<sup>51</sup> In 1999, of the 55,408 offenders sentenced in the federal courts, roughly 11,000 were sentenced for the offenses of fraud, larceny, embezzlement, burglary, or robbery, all of which involve calculations of loss amount under the applicable guidelines. 1999 SOURCEBOOK, *supra* note 13, at 12, tbl. 3.

versely, if we can agree on the core principles and keep them in mind as we consider particular problems, the particular problems will be fairly easy to resolve. Therefore, before discussing the details of the CLC proposal on the definition of 'loss,' we will consider certain fundamentals.

### A. *Loss and Punishment of Economic Crime*

In general, the criminal law imposes punishment when a defendant has been found culpable either for causing or intending to cause *harm* to another person or to society. The seriousness of a criminal offense is the product of several factors, including the degree of harm caused or intended, the culpable mental state of the defendant, and (in the case of completed offenses) the causal relationship between the defendant's actions and the harm caused. The Guidelines impose increasing levels of punishment as the Offense Level (a numerical measurement of offense seriousness) increases. In economic crimes, the type of harm caused or intended is customarily pecuniary (though other types of harm can result from predominantly economic crime). Consequently, the largest component in the Offense Level calculation for economic crimes is loss.

At the risk of oversimplifying somewhat, the loss figure is designed to serve as the primary measure (or, at the least, *one* of the primary measures) of offense seriousness in economic crimes. It performs its role in slightly different ways depending on whether the crime was a completed offense, a partially completed offense, or a wholly inchoate offense such as an attempt or unsuccessful conspiracy. In completed offenses, loss provides both a direct measurement of harm to victims and a proxy measurement of the defendant's culpable mental state.<sup>52</sup> First, the larger the victim's economic loss, the greater the harm caused. Second, a defendant who steals a large amount is usually thought to be more blameworthy than one who steals only a small sum, both because the intention to cause a large harm is more blameworthy than an intention to cause a smaller one, and because a successful scheme to steal a large amount generally involves longer planning and premeditation. Therefore, in completed offenses, a larger loss should, in general, be punished more severely than a smaller loss.

In inchoate offenses, 'intended loss' serves as a direct measurement of culpable mental state and as an important indicator of the degree of risk of actual harm posed by the defendant's conduct. Whatever the context, it is fair to say most observers have concluded that loss is, first and foremost, a quantitative measurement of the pecuniary *harm* that the defendant either caused or intended.

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<sup>52</sup> See generally, Bowman, *supra* note 14, at 497-503.

## B. *Causation*

Even in completed offenses, the simple equivalency between pecuniary harm inflicted and offense seriousness becomes more complex when the defendant's criminal conduct caused economic harms that the defendant did not specifically desire (even though he may have realized that they might well result), or from which he did not personally benefit. For example, a defendant in a fraudulent loan application case, hopeful that his 'ship would come in' in time to make repayment, may not have intended that the bank lose its loan money. Or the author of a telemarketing scheme might not intend that his elderly victims lose their homes as a result of losing their retirement savings to the telemarketer. In these and many other cases, whether the defendant is to be held culpable for particular economic losses to victims, and thus whether the loss number and perhaps his offense level may be increased, will depend on the legal question of *causation*. In other words, was the causal link between the defendant's conduct and the economic harm that resulted sufficiently direct that the law should hold the defendant responsible and increase his punishment accordingly?

The literature of criminal law, contracts, and torts usually conceives of causation problems as having two components, customarily labeled cause-in-fact and legal cause.<sup>53</sup> Cause-in-fact is about determining the causal relationship between a defendant's act and a subsequent harm to another.<sup>54</sup> It asks whether the conduct truly was a part of the chain of events in the physical world that brought about the harm. Legal cause asks a different question: Assuming that the defendant's conduct truly did play a role in bringing about the harm, is it just to impose legal liability for the harm concededly caused?<sup>55</sup> For example, a hiker who dislodges a pebble on a mountainside may start an avalanche that obliterates a village below. Cause-in-fact is concerned only with the issue of whether the dislodged pebble started the avalanche. Legal cause is about whether, assuming that the pebble did cause the slide, the hiker should, as a matter of law, be held accountable and punished for the destruction of the village and the death of the villagers.

In both civil and criminal law, the most common causation standard is 'reasonable foreseeability.'<sup>56</sup> To a certain extent, the familiar reasonable foreseeability standard commingles the analytically distinct questions of cause-in-fact and legal cause. That is, under a reasonable foreseeability standard, a defendant will be held civilly liable or criminally culpable for

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<sup>53</sup> For an extended discussion of the problem of causation in economic crime sentencing, as well as the relationship of thinking about causation in other areas of the law to this problem, see Bowman, *supra* note 14, at 527-36.

<sup>54</sup> *Id.* at 530-31.

<sup>55</sup> *Id.* at 532-36.

<sup>56</sup> *Id.*

harms that (1) were caused in fact by defendant's conduct, in the sense that they would not have occurred but for defendant's conduct, and (2) were, at the time of defendant's illegal conduct, foreseeable to a reasonable person in defendant's position. At present, the Guidelines do not address the issue of causation of loss, except indirectly.<sup>57</sup>

### C. *The CLC's Core Definition of 'Actual Loss'*

During the past four years, a broad consensus has emerged on two points: (1) that the basic definition of actual loss should specify the required causal connection between the defendant's criminal conduct and the economic harms to be counted in loss, and (2) that the causation standard for actual loss under the Guidelines should express the idea that defendants should be held responsible for harms that would not have occurred *but for* a defendant's conduct and that were *reasonably foreseeable* to him. The CLC proposal expresses this consensus. The judges propose that 'actual loss' be defined as follows:

'Actual loss' means the reasonably foreseeable pecuniary harm that resulted or will result from the conduct for which the defendant is accountable under section 1B1.3 (Relevant Conduct).

'Reasonably foreseeable pecuniary harm' means pecuniary harm that the defendant knew or, under the circumstances of the particular case, reasonably should have known likely would result in the ordinary course of events from the conduct for which the defendant is accountable under section 1B1.3 (Relevant Conduct).<sup>58</sup>

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<sup>57</sup> See *supra* notes 44-51 & accompanying text, describing the patchwork treatment of causation implied by current guidelines provisions, including the relevant conduct Guideline, U.S.S.G. § 1B1.3, and inclusion of the contracts term 'consequential damages' in U.S.S.G. § 2F1.1, n.8(c).

<sup>58</sup> See *CLC Draft*, § 2(A), *infra* App. A. The 2001 Staff Draft incorporates the CLC language as § 2A (Option 1). *2001 Staff Draft*, *supra* note 11.

The April 1998 draft definition of 'reasonably foreseeable pecuniary harm' used in the 1998 field test read as follows: "'Reasonably foreseeable pecuniary harm' means pecuniary harm that the defendant knew, or under the circumstances of the particular case, should have known would likely follow, in the ordinary course of events, as a result of that conduct." *Field Test*, *supra* note 6. The CLC draft makes only minor clarifying changes to the April 1998 draft. The CLC draft adds the word 'reasonably' before the phrase 'should have known.' It also eliminates some redundancy in the April 1998 version by substituting the phrase "likely would result, in the ordinary course of events, from that conduct," for the original "would likely follow, in the ordinary course of events, as a result of that conduct." Compare CLC Draft, § 2(A), *infra* App. A, with *Field Test* § 2(A), *supra* note 6 (emphasis added) (Apr. 1998 draft).

The CLC draft improves on the April 1998 field test draft in at least one additional respect. The April 1998 draft used the phrase 'that conduct' without saying which conduct is referred to. This is not a big substantive issue because the reader of the April 1998 draft will quickly deduce that the 'conduct' is the conduct alluded to in the definition of 'actual loss.' However, any imprecision has been cleared up by amending the April 1998 draft to add language tracking the 'actual loss' definition: 'Reasonably foreseeable pecuniary harm' means pecuniary harm that the defendant knew, or under the

Despite the broad consensus in favor of defining actual loss in terms of pecuniary harms reasonably foreseeable to the defendant, there are dissenting views, which are considered below.

### 1. Leaving Causation Undefined Is Not a Viable Option

It has occasionally been suggested that placing a causation standard in the loss definition is just too troublesome, and thus we should maintain the status quo by omitting any reference to cause. Putting it as mildly as possible, this is not a tenable option. No coherent definition of loss is possible without a specification of the required causal nexus between the crime and economic harms that are to be counted as loss. Even if the Commission were to ignore the question of causation, courts construing the economic crime Guidelines do not have that luxury. The causation issue is latent in every loss determination, and is the pivotal question in many cases.<sup>59</sup> Moreover, a well-defined causation standard not only provides the immediate rule of decision in some number of cases, but serves as the central organizing principle against which special rules governing particular loss measurement problems should be measured. It would be irresponsible of the Commission to promulgate a purportedly reformed definition of loss that gave courts no guidance on so central an issue.

### 2. Reasonable Foreseeability Is the Best Available Causation Standard

There are those who, while conceding that some causal standard is doubtless necessary, remain skeptical of the particular standard—‘but for’ causation plus reasonable foreseeability—that has emerged over the past

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circumstances of the particular case reasonably should have known, likely would result, in the ordinary course of events, from the conduct for which the defendant is accountable under § 1B1.3 (Relevant Conduct). *CLC Draft, infra* App. A, § 2(A).

<sup>59</sup> See, e.g., *United States v. Hicks*, 217 F.3d 1038, 1048 (9th Cir. 2000), *amended by*, 2000 U.S. App. LEXIS 518279 (employing proximate cause analysis to determine loss); *United States v. Needle*, 72 F.3d 1104 (3d Cir. 1995), *amended by*, 79 F.3d 14 (1996) (discussing the necessary causal connection between the conduct of a defendant who lied about the undercapitalization of his insurance company and insurance losses sustained in the wake of Hurricane Hugo). See also *United States v. Yeaman*, 194 F.3d 442 (3d Cir. 1999) (rejecting zero loss where defendant’s misrepresentations had ‘but for’ causal connection to loss); *United States v. Green*, 114 F.3d 613 (7th Cir. 1997) (charging nurse who created false bills as part of insurance fraud scheme with entire loss, including payments for pain and suffering, because insurance settlements are customarily based on size of medical bills); *United States v. Copus*, 110 F.3d 1529 (10th Cir. 1997) (finding in loan fraud case that loss limited to pecuniary harm attributable to false statement); *United States v. Cheng*, 96 F.3d 654 (2d Cir. 1996) (wholesaler who accepted food stamps from restaurants caused loss); *United States v. Krenning*, 93 F.3d 1257 (5th Cir. 1996) (finding district court’s method of valuing loss bore no reasonable relation to harm from fraud); *United States v. Kopp*, 951 F.2d 521 (3d Cir. 1991) (suggesting proximate cause analysis).

four years and is now embodied in the CLC proposal.<sup>60</sup> The most obvious rejoinder to this skepticism is to inquire what alternative standard the skeptics would prefer. To this question there has, to date, been no response. Careful analysis of the competing alternatives provides an explanation for the silence. On the one hand, a pure ‘but for’ causation standard would be too inclusive. Chains of cause and effect run on infinitely through time. To hold a defendant criminally responsible for every adverse pecuniary consequence of his wrongdoing, no matter how remote or unforeseeable, plainly would be unfair to the defendant.

Conversely, limiting loss to intended economic harms that the defendant consciously desired would be too restrictive a measurement of offense seriousness. If a corporate treasurer embezzles company funds to speculate in futures trading or to place bets at the dog track, he may not intend to deprive the company of the money. He may honestly intend to make good his defalcations, with interest, but when the orange crop freezes or the dogs don’t run, his good intentions do not reduce the company’s financial loss and should not reduce the corporate treasurer-turned-defendant’s sentence. When the owner of a business starts kiting checks to tide over cash flow problems, he may hope that his business will turn a corner and all the checks can be made good. But when the business does not turn the corner and the kite collapses leaving banks holding hundreds of thousands of dollars of worthless paper, the economic harm to the banks is not lessened by the defendant’s unfounded optimism. When a real estate swindler lies to the bank financing a development, to his partners, to purchasers of the lots, and to contractors working on the project, he may intend to steal for himself only a small fraction of the money and resources invested in the project. But the entirely predictable result of his crimes may be the collapse of the undertaking and financial harm to the bank, his partners, the purchasers, and the contractors far in excess of the personal gain on which the swindler’s attention was focused. Similarly, if a con man convinces an old woman to borrow against the equity in her home to invest in worthless stock, and as a result the woman loses both her investment and her home, the economic harm to the woman is both the money the defendant intended to steal for himself and the additional financial losses the victim suffered in consequence of the foreclosure of her home.

In short, limiting actual loss to the amount subjectively intended by the defendant does not accurately measure the economic harm caused by

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<sup>60</sup> This line of thinking would seem to be the impetus behind section 2(A) (Option 2) in the Commission Staff proposal published in January 2001. See *2001 Staff Draft*, *supra* note 11. The staff offers the option of defining ‘actual loss’ as “the pecuniary harm that resulted or will result from the conduct for which the defendant is accountable under § 1B1.3 (Relevant Conduct). *Id.* The commentary accompanying Option 2 states that the purpose of this option would be to “make clear ‘but for’ causation is required but without concept of reasonable foreseeability.” *Id.*

the defendant's crimes, and it permits the defendant to limit his sentencing exposure by making difficult-to-disprove claims about his benevolent intentions or about his failure to consider the likely consequences of his crime. A proper causation standard for loss will thus lie somewhere between the purely objective standard of 'but for' causation and a purely subjective inquiry into the defendant's intentions. The CLC definition fits this bill. It insists, as a minimum, that a defendant's criminal conduct (or the foreseeable conduct of his criminal partners) must be a cause-in-fact of the economic harm at issue. However, it limits the defendant's sentencing liability to those losses that a reasonable person should have foreseen.

### 3. The Criminal Law Traditionally Imposes Punishments for Reasonably Foreseeable Harms Caused by a Defendant's Criminal Conduct

It has been suggested from time to time that holding defendants criminally responsible for reasonably foreseeable harms caused by their illegal conduct is some sort of radical innovation. In fact, exactly the reverse is true. The concept of foreseeability has long been a staple of analysis both in determining guilt and in imposing sentences.<sup>61</sup> Foreseeability is expressly an element of crimes where the prohibited mental state is criminal negligence<sup>62</sup> and even the most aggravated degrees of recklessness.<sup>63</sup> It is also integral to determinations of guilt for crimes in which the ostensible *mens rea* involves intentionality or knowledge.<sup>64</sup> For example, a party to a conspiracy is responsible for any crime committed by a co-conspirator if it is within the scope of the conspiracy, or is a foreseeable consequence of the unlawful agreement.<sup>65</sup> In cases of accomplice liability, an accomplice

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<sup>61</sup> The notion of causation runs throughout the law—including the criminal law—and it is generally understood to encompass two concepts. A defendant's conduct must generally be both the 'cause in fact' and the 'proximate cause' of some harm before liability is imposed. *United States v. Neadle*, 72 F.3d 1104, 1119 (3d Cir. 1996) (Becker, J., concurring and dissenting).

<sup>62</sup> See, e.g., MODEL PENAL CODE, § 2.02(2)(d) (defining criminal negligence to require that defendant should have been aware of a substantial and unjustifiable risk of harm).

<sup>63</sup> See, e.g., *Henderson v. Kibbe*, 431 U.S. 145, 156-57 (1977) (finding foreseeability of death a necessary component of depraved indifference murder under New York law); *Regina v. Cunningham*, 2 Q.B. 396 (1957) (holding that 'malice' under the Offenses against the Person Act, 1861, embraces both intentional and reckless conduct and recklessness requires evidence that defendant foresaw the threatened injury).

<sup>64</sup> See, e.g., *People v. Rakusz*, 484 N.Y.S.2d 784 (N.Y. Sup. Ct. 1985) (finding defendant guilty of assault, defined as: "with intent to prevent . . . a police officer . . . from performing a lawful duty, he causes physical injury to [the officer], when an officer frisked a struggling defendant and cut his hand on the knife, because the injury was foreseeable to defendant"); *State v. Williquette*, 385 N.W.2d 145 (Wis. 1986) (holding that a defendant "subjects a child" to abuse if, by act or omission, "she causes the child to come within the influence of a foreseeable risk of cruel maltreatment").

<sup>65</sup> *Pinkerton v. United States*, 328 U.S. 640, 647-48 (1946). See also *United States v. Laurenzana*, 113 F.3d 689, 693 (7th Cir. 1997) (defendant guilty of conspiracy to commit mail fraud where he enters scheme in which it is reasonably foreseeable that mails will be used).



“is guilty not only of the offense he intended to facilitate or encourage, but also of any reasonably foreseeable offense committed by the person he aids and abets.”<sup>66</sup> The felony-murder rule, which imposes liability for the highest available degree of criminal homicide for killings occurring during certain dangerous felonies, in effect substitutes foreseeability of death for the intent to cause it.<sup>67</sup>

Foreseeability of harm is also widely employed as a determinant of the harms to be considered in sentencing. The Guidelines themselves repeatedly use foreseeability as the dividing line between those harms which count for measuring offense seriousness and those which do not.<sup>68</sup> Inclusion of reasonably foreseeable harms in the criminal sentencing calculus has received the imprimatur of the United States Supreme Court, even in the capital sentencing context. In *Payne v. Tennessee*,<sup>69</sup> the Court approved the use of victim impact evidence over the objection that such evidence concerns “factors about which the defendant was unaware, and that were irrelevant to the decision to kill,” and thus had nothing to do with the “blameworthiness of a particular defendant.”<sup>70</sup> Justice Souter, in his concurrence, responded to this line of argument by observing that the harms to the surviving victims of homicide (the families, friends, communities, and loved ones of the deceased) portrayed in victim impact evidence are morally, and therefore legally, relevant precisely because they are so plainly foreseeable.<sup>71</sup>

<sup>66</sup> *People v. Croy*, 710 P.2d 392, 398 n.5 (Cal. 1985). See generally, DRESSLER, *supra* note 43, § 30.05[B][5] at 443.

<sup>67</sup> Some jurisdictions apply the felony murder rule to all deaths caused in fact by the commission of designated dangerous felonies, on the theory that such felonies always present a particular risk of death. WAYNE R. LAFAVE & AUSTIN W. SCOTT, JR., *CRIMINAL LAW*, § 7.5(b), at 624-25 (2d ed. 1986). Other jurisdictions impose a specific requirement that the death in the particular case have been a foreseeable outcome of defendant's felony. *Id.* § 7.5(d) at 626-27.

<sup>68</sup> See, e.g., U.S.S.G. § 1B1.3(a) (dictating that sentencing be based on harms resulting from the foreseeable conduct of defendant's criminal partners); U.S.S.G. § 2F1.1, n.8(c) (including in loss foreseeable consequential damages in procurement fraud and product substitution cases). See also U.S.S.G. § 2F1.1, n.10(a) (authorizing a departure for 'reasonably foreseeable non-monetary harm'), U.S.S.G. § 2F1.1, n.10(c) (authorizing departure for 'reasonably foreseeable' physical, psychological, or emotional harm). See also *United States v. Sarno*, 73 F.3d 1470 (9th Cir. 1995) (finding all losses on fraudulently procured loan attributable to the defendant even where the default was not his fault because it was reasonably foreseeable from the defendant's conduct that the loan would be approved, putting the bank's money at risk).

<sup>69</sup> 501 U.S. 808 (1990).

<sup>70</sup> *Id.* at 818 (quoting *Booth v. Maryland*, 482 U.S. 496, 504, 505 (1987)).

<sup>71</sup> Said Justice Souter:

Murder has foreseeable consequences. . . . Every defendant knows, if endowed with the mental competence for criminal responsibility, that the life he will take by his homicidal behavior is that of a unique person, like himself, and that the person to be killed probably has close associates, 'survivors,' who will suffer harms and deprivations from the victim's death. . . . The foreseeability of the killing's consequences imbues them with direct moral relevance, . . . and evidence of the specific harm caused when a homicidal risk is realized is nothing more than evidence

#### 4. A Reasonable Foreseeability Standard Requires an Assessment of the Defendant's Blameworthiness for the Economic Harms He Caused

Some Guidelines critics (including a number who participated in the Symposium) have complained that the heavy influence of the loss calculation on sentence length elevates an accounting exercise over more refined considerations of the defendant's state of mind, and ultimately of his blameworthiness.<sup>72</sup> In my view, this criticism has always been somewhat misconceived because loss, however defined, is always a rough proxy measurement of a defendant's guilty mind, at least insofar as we can agree that a plan to steal a lot is more blameworthy than one to steal a little. Moreover, the CLC definition of loss represents an improvement over the status quo precisely because it requires a judicial judgment about a defendant's fault for identified harms. It is unjust to put someone in prison for harms he neither intended nor could reasonably have anticipated would follow from his choice to do wrong. It is entirely appropriate, however, to punish based on harms that would not have occurred but for the defendant's evil choices, and which the defendant either anticipated or could and should have anticipated. The CLC's reasonable foreseeability standard obliges the sentencing court to consider the facts of the case from the perspective of a reasonable person in defendant's situation when it separates harms for which a defendant ought justly to be punished from those for which he should not.

#### 5. The CLC Loss Definition Will Not Generate Excessive Litigation

Some have worried that defining actual loss as the pecuniary harms caused by the crime and reasonably foreseeable to the defendant will "generate excessive litigation."<sup>73</sup> While one understands the caution be-

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of the risk that the defendant originally chose to run despite the kinds of consequences that were obviously foreseeable.

*Id.* at 838-39 (Souter, J., concurring) (emphasis added).

In dissent, Justice Stevens tacitly concedes that impact on surviving victims would be relevant if foreseeable. His argument is simply that the majority's holding "permits a jury to sentence a defendant to death because of harm to the victim and his family that the defendant could not foresee, which was not even identified until after the crime had been committed, and which may be deemed by the jury, without any rational explanation, to justify a death sentence in one case and not in another." *Id.* at 863 (Stevens, J., dissenting) (emphasis added).

<sup>72</sup> See the comments of Judge Jon Newman of the United States Court of Appeals for the Second Circuit, and others, at the Second Plenary Session of the Third Symposium on Crime and Punishment in the United States, Oct. 12, 2000, available at <http://www.uscc.gov/AGENDAS/symposium.htm>.

<sup>73</sup> See the comments of several participants in Concurrent Breakout Session, Group One, Third Symposium on Crime and Punishment in the United States, Oct. 12, 2000, available at

hind this concern, the concern itself seems largely unwarranted. To begin, the fear of ‘excessive’ litigation objection implies that the meaning and application of current guidelines and case law on loss is so clear and well-settled that there is not presently much litigation in this area, which is of course patent nonsense. *Any* more-than-trivial change in sentencing law ‘generates’ an initial burst of litigation in the period immediately following its adoption. However, if that is thought an insuperable obstacle to reforming the law, then no new law should ever be passed. The real question is whether, after the initial burst of litigation activity, the new rules will be better than the old rules. A comparison of the CLC proposal with current guidelines provisions on loss yields a high degree of confidence that the new rules would indeed be better, simpler, more workable, than the old.

Finally, those with lingering reservations about a cause-based definition of loss should derive considerable reassurance from the fact that two separate groups of federal judges—the participants in the 1998 field test and the CLC—have overwhelmingly endorsed the basic loss definition contained in the CLC proposal.<sup>74</sup> Above all other groups, federal judges can be relied upon to embrace simplifying reforms and to recognize and reject proposals that promise to generate nonessential litigation. As will be discussed in the next section, the CLC proposal on loss contains not only a cause-based core definition, but also and significantly, a series of provisions limiting the categories of reasonably foreseeable harms to be included in loss.

#### D. *Restrictions on Categories of Reasonably Foreseeable Harms Included In Loss*

The CLC was not oblivious to the fact that some foreseeable consequences of criminal conduct ought not to be included in the definition of loss. Accordingly, the CLC proposal, in common with its 1998 predecessor, contains significant limitations on the scope of those reasonably foreseeable harms that can be included in the loss calculation.

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<http://www.ussc.gov/AGENDAS/symposium.htm>.

<sup>74</sup> The CLC voted unanimously to forward its proposed loss redefinition to the Commission for publication. The response of judges participating in the 1998 field test was similarly enthusiastic. The Commission gathered 22 federal judges and 21 probation officers and asked them to apply the existing loss definition and a less-refined version of the current proposal to a selection of randomly selected and self-selected cases, and then to compare the results. (The loss definition used in the Field Test was the so-called “April 1998 Draft” loss re-definition. Its core definition of loss was nearly identical to the CLC draft. *See supra* note 58 and accompanying text.) Of the forty-three participants, all but two judges and one probation officer found the new definition logically organized and easy to follow. And as the Commission later reported, “the near-universal consensus among both judges and probation officers was the proposed definition was preferable to the current formulation.” *See Field Test, supra* note 6.

## 1. Loss Includes Only Pecuniary Harms

The injuries to victims of theft, fraud, and other ‘economic’ crimes are not necessarily limited to economic harm. Victims may suffer emotional harm, damage to reputation, disruption of personal or business relationships, or even physical illness. Because harms of this sort are often foreseeable to defendants, one might, as the economists say, ‘monetize’ non-economic harms by assigning monetary values to injuries such as emotional distress (as courts and juries do routinely in civil lawsuits) and include the resulting figures in loss. There is no support in the CLC for including non-economic harms in loss. The CLC proposal specifically excludes non-economic harms by defining loss to include only ‘pecuniary harms.’<sup>75</sup>

## 2. The CLC Excludes from Loss Foreseeable Investigative Costs of the Government, and Costs Incurred by Victims in Aiding the Government

One of the foreseeable consequences of crime is that the government will investigate and prosecute those offenses of which it becomes aware. It is also foreseeable that victims of crime will assist the investigation. Criminal investigations and prosecutions cost money. Thus, one might include in loss the foreseeable costs of investigating and prosecuting the defendant’s crimes. However, there is virtually universal agreement that such costs should not affect sentence length.<sup>76</sup> First, the amount of money the government spends to investigate and prosecute a case often depends on fortuitous factors unrelated to the seriousness of the offense or the defendant’s overall blameworthiness—considerations such as the thoroughness of the investigators, the number and location of witnesses, whether expert witnesses or specialized forensic techniques are required, and so forth. Second, even if investigative costs could be shown to bear some rough relationship to offense seriousness or defendant culpability, the investment of judicial time and resources necessary to accurately determine investigative costs would be unlikely to produce commensurate gains in the accuracy of the loss figure as a measurement of relative culpability

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<sup>75</sup> Should the Commission wish to make the exclusion of non-economic harms even more explicit, it could easily do so. I have suggested elsewhere that the guidelines commentary on ‘loss’ contain language to this effect: “The phrase ‘pecuniary harm’ is to be given its common meaning. Many physical and emotional harms, injuries to reputation, etc. can be assigned a monetary value. However, ‘loss’ does not measure harms of this kind. Its purpose is to measure economic harms.” See Bowman, *supra* note 14, at 572.

<sup>76</sup> No participant in the long series of discussions on revising the loss definition has ever suggested including investigative costs in loss. Both the CLC draft and the 2001 Staff Draft specifically exclude government investigative costs and costs incurred by victims to assist government investigations. See *CLC Draft*, *infra* App. A, § 2(B)(ii); *2001 Staff Draft*, *supra* note 11, § 2(C)(ii).

between defendants.

In consequence, the CLC proposal specifically excludes investigative and prosecution costs from loss. Section 2(b)(ii) states that loss “does not include . . . [c]osts to the government of, and costs incurred by victims primarily to aid the government in, the prosecution and criminal investigation of an offense, even if such costs are reasonably foreseeable.”<sup>77</sup>

### 3. The CLC Excludes Interest from Loss

The Guidelines now exclude interest from loss. Application Note 8 to section 2F1.1 says that loss “does not . . . include interest the victim could have earned on such funds had the offense not occurred.”<sup>78</sup> Nonetheless, interest has surfaced as a problem because a number of courts of appeals have (depending on one’s point of view) either simply ignored the Guidelines or interpreted them creatively in order to include ‘bargained-for’ interest in loss.<sup>79</sup> The CLC considered two approaches to interest: (1) exclude all interest, including both bargained-for and opportunity cost interest, or (2) include interest only in cases in which the promise of a return on investment was part of the inducement to fraud (‘bargained-for’ interest). After considering the arguments outlined below, the CLC decided on a categorical exclusion of interest of all types from loss.<sup>80</sup>

#### a. Arguments for Inclusion of Interest

Consistency with the core definition of loss suggests inclusion of interest. If a criminal steals money that the victim would otherwise have loaned to or invested with an honest person or institution, it is reasonably

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<sup>77</sup> *CLC Draft, infra* App. A, § 2(B)(ii).

<sup>78</sup> U.S.S.G. § 2F1.1, n.8 (2000).

<sup>79</sup> See *United States v. Sharma*, 190 F.3d 220 (3d Cir. 1999) (distinguishing ‘opportunity cost interest’ from ‘bargained-for interest’ and including the latter in loss); *United States v. Nolan*, 136 F.3d 265 (2d Cir. 1998); *United States v. Gilberg*, 75 F.3d 15 (1st Cir. 1996) (including \$726,637 in accrued mortgage loan interest); *United States v. Goodchild*, 25 F.3d 55 (1st Cir. 1994) (including finance charges and late fees in loss from unauthorized credit card use); *United States v. Henderson*, 19 F.3d 917, 928 (5th Cir. 1994) (“Interest should be included if: the victim had a reasonable expectation of receiving interest from the transaction.”); *United States v. Jones*, 933 F.2d 353, 354-55 (6th Cir. 1991) (finding interest should be included where defrauded credit card companies had reasonable expectation of specific return on credit extended); *cf.*, *United States v. Allender*, 62 F.3d 909, 917 (7th Cir. 1995) (overruling *U.S. v. Clemmons*, 48 F.3d 1020, 1025 (7th Cir. 1995), and finding loss includes bargained-for interest); *United States v. Moored*, 38 F.3d 1419, 1423 (6th Cir. 1994) (stating in dictum that loss does not include interest); *United States v. Lowder*, 5 F.3d 467, 471 (10th Cir. 1993) (holding interest should be included where defendant promised victims a specific interest rate).

The Fourth Circuit excludes interest categorically. *United States v. Hoyle*, 33 F.3d 415, 419 (4th Cir. 1994). See also *United States v. Allen*, 88 F.3d 765 (9th Cir. 1996).

<sup>80</sup> The CLC proposal would exclude from loss: “Interest of any kind, finance charges, late fees, penalties, anticipated profits, or amounts based upon an agreed-upon rate of return.” *CLC Draft, infra* App. A, § 2(B)(i).

foreseeable that the victim will lose not only his principal, but also the time value of that money. Loss of the time value of money is, from an economic point of view, indisputably a harm suffered by the victim of a fraud. But the consistency argument proves too much. If we are to include in loss the time value of stolen money, then consistency dictates that we include time value not only when the defendant defrauds a victim by promising payment of interest, but also when he promises a return on investment in the form of dividends, capital gains, or profits. A defendant's sentence should not turn on the fortuity of the name used to characterize the promised return on investment. Likewise, a victim suffers the harm of lost time value of his money even if the scheme is one that involves no promise of return on investment. For example, an insurance company defrauded by an insured who torches his own business and then collects fire insurance proceeds is deprived of the time value of the insurance payout no less than it would be if the company had lost the same amount by investing it with a crooked stock broker who falsely promised a high rate of return.

b. 'Bargained-for' Interest

Some courts have sought to evade the current prohibition against including interest in loss by including interest specifically promised by a defendant as part of the inducement to the victim to part with his money. The approach of those courts gives rise to strong theoretical and practical objections.

First, loss is primarily a measurement of actual harm actually suffered by the victim, not of the magnitude of the false promises of the crooked defendant. If a defendant defrauded victim A by promising payment of ten percent interest monthly, A's actual loss is not his principal plus 120% annual interest *because there was never a realistic possibility that the defendant or anyone else would pay him interest at that rate*. The only reliable measure of what the victim lost by giving his money to the defendant rather than investing it with an honest person is the market rate for invested money. (Even this is highly speculative because there is no way of knowing whether the victim would indeed have invested it.)

Second, using the interest rate promised by defendants creates a disparity of punishment between similarly situated defendants. Three defendants who stole the same amount of money should not receive different sentences merely because the first falsely promised his victims a fifty percent return, the second promised 100%, and the third committed a form of fraud (like the arsonist who defrauded his fire insurer in the example above) that involved no promise of return on investment. Likewise, two defendants who stole the same amount of money by falsely promising a

twenty-five percent return on investment should not receive different punishments because the first characterized the promised payment as interest while the second happened to call the promised payment dividends.

Third, using different interest rates in every case adds to sentencing complexity. There will be inevitable disputes over exactly what rate of return was promised. Particularly in multi-victim fraud cases, it will often prove that the defendant promised different rates of return to different victims. In such cases, the court would not only have to make findings about exactly what was promised each of perhaps dozens or hundreds of victims, but then someone would have to do the resulting math to arrive at a loss number.

Courts may have been drawn into including bargained-for interest by two unarticulated lines of thought. The first is an unconscious reversion to memories of first-year contracts and the recollection that aggrieved contract litigants are often entitled to the 'benefit of the bargain' as a measure of damages.<sup>81</sup> But this is not a contracts problem. In contracts, courts are concerned, not with punishment of the morally blameworthy, but with enforcement of (primarily commercial) agreements.<sup>82</sup> The benefit of the bargain rule, when it is applicable, focuses on ensuring that the non-breaching party is disadvantaged as little as possible by the breach of the agreement, not by measuring moral culpability of the party in breach. Moreover, even in contracts, the prevailing litigant is only sometimes entitled to the benefit of his bargain; other measures of damages are as or more common.<sup>83</sup>

The second idea that may lie behind the 'bargained for' interest cases is the notion that the magnitude of the defendant's false promises is somehow a proxy measurement for the defendant's blameworthiness. But this is a false equivalency. A crook who euchres a victim out of \$1,000 by falsely promising a ten percent monthly return is by no rational calculation either more or less blameworthy than another crook who inveigles the victim into parting with the same \$1,000 with a false promise of a fifteen percent monthly return. The harm to the victim in both cases is the same, and the true measure of each defendant's blameworthiness is his settled desire to cheat the victim of \$1,000, rather than the particular false promises he

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<sup>81</sup> See, e.g., JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 219, at 438 (1974) ("The purpose of contract law is often stated as the fulfillment of those expectations which have been induced by the making of a promise. If the promise is breached the legal system protects the expectations by attempting to place the injured promisee in the position he would have been in had the promise been performed.").

<sup>82</sup> The law of contracts is concerned with the securing and protection of those economic interests which result from assurances. *Id.* § 1, at 2.

<sup>83</sup> See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 344, cmt. a (1979) (emphasizing that securing to a non-breaching promisee the benefit of his bargain is only one of three interests served by the law of remedies for breach of contract, the other two being reliance and restitution, and that the relief granted "may not correspond precisely to any of these interests").

makes in his efforts to do so.

In short, among the competing proposals regarding interest, the 'bar-gained for' interest option is the least desirable of the lot.<sup>84</sup>

### c. Arguments for Total Exclusion of Interest

The CLC has concluded that simplicity should trump blind theoretical consistency, and therefore that interest should be excluded from loss altogether. Including interest introduces the previously-discussed problems of equity between defendants and of complex calculation, but it does little to make loss a more accurate measure of relative offense seriousness. Indeed, particularly if interest is assessed at a standardized market rate,<sup>85</sup> the interest component of loss is really a proxy measurement, not of relative offense seriousness, but of the length of time elapsed between the taking of the money and the date that loss is measured in preparation for sentencing. For example, assume two defendants each steal \$10,000 by the same means on the same date, but one is sentenced six months and the other eighteen months after the crime. If loss is measured as of the date of the sentencing, the defendant sentenced later would have more interest added to his loss figure and therefore, at least potentially, would receive a longer sentence. This is an absurd and unjust result.

Even if loss is to be measured at the time of detection,<sup>86</sup> then accrued interest becomes a proxy measurement for the length of time the defendant evaded detection. This may arguably bear some attenuated relationship to culpability, but it is a long stretch. At the end of the day, the CLC could find no convincing reason why courts should expend valuable resources on quantifying interest as an element of loss when the result of the labor advances the purposes of sentencing so little. Moreover, excluding interest eliminates one of the most common of the foreseeable peripheral harms that would be likely to cause dispute and delay in the sentencing process.

### d. The CLC Proposal Regarding Interest

The CLC proposal states that "[i]nterest of any kind, finance charges,

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<sup>84</sup> Had the CLC proposed including in 'loss' interest of any type, I would have recommended that the Commission use a standard interest rate for all defendants. This would ameliorate some of the problems identified above. It would accurately measure the true economic worth of the harm suffered by victims fraudulently deprived of the time value of their money, and it would eliminate the inequities created by calculating the sentences of defendants who stole identical amounts based on the fortuity of the particular false promises they made. Federal law establishes a rate to be paid to litigants in civil cases in 28 U.S.C. § 1961. If interest in any form were to be added into loss, the simplest, most equitable, and most theoretically sound way of doing so would be to use a standard statutory rate.

<sup>85</sup> *Id.*

<sup>86</sup> See *infra* note 121 and accompanying text (recommending time of detection as the proper time of measurement for loss).



late fees, penalties, anticipated profits, or amounts based on an agreed-upon return or rate of return” shall not be included in loss.<sup>87</sup> Option One of the Commission’s staff draft of January 2001, in common with an earlier staff draft dated May 1999, goes further and excludes not only interest, but also ‘opportunity costs,’ from the loss calculation.<sup>88</sup> This provision was deleted by the Sentencing Subcommittee of the CLC (Subcommittee). Subcommittee members observed that the phrase ‘opportunity costs’ is a technical term drawn not from law, but from economics, and felt that putting a term of art from another discipline into the Guidelines would be, at the least, risky because such terms can prove to have implications not obvious to the lawyers who adopted them. Moreover, the interaction between the general rule of including foreseeable harms in loss and a special rule excluding opportunity costs is likely to generate further confusion.

Moreover, the CLC does not provide for an upward departure based on the presence of large amounts of interest.<sup>89</sup> The point of excluding interest is that including it produces difficulties in calculation, invites disparate sentences, and is unlikely to make the resulting loss figure a more accurate measure of relative culpability. A categorical exclusion produces substantial gains in simplicity and clarity. Circuit courts have already proved remarkably adept at slipping interest into loss, even in the face of the existing prohibition against it. Leaving the back door ajar by putting in a departure provision risks more of the same. Moreover, it is difficult to imagine a case where the size of the interest figure would merit a departure. If such cases exist, the general departure provision of the Guideline would seem adequate to deal with it.

#### E. *Net vs. Gross Loss: The Problem of Accounting for Things of Value Transferred to the Victim by the Defendant*

##### 1. Current Law

Under current law, the actual loss is the net loss to the victim. The commentary to the fraud Guideline requires that any loss suffered by a fraud victim be offset by any value received in the transaction. For example, Application Note 8(b) to section 2F1.1 states:

A fraud may involve the misrepresentation of the value of an item that does have some value (in contrast to an item that is worthless). Where, for example, a defendant fraudu-

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<sup>87</sup> *CLC Draft, infra* App. A, § 2(B)(i).

<sup>88</sup> *2001 Staff Draft, supra* note 11, § 2(C)(i) (Option 1); *May 1999 Draft, supra* note 8.

<sup>89</sup> The staff included the presence of a ‘substantial amount of interest’ as an upward departure factor. *2001 Staff Draft, supra* note 11, § 11(A)(iii).

lently represents that stock is worth \$40,000 and the stock is worth only \$10,000, the loss is the amount by which the stock is overvalued (i.e. \$30,000). In a case involving a misrepresentation concerning the quality of a consumer product, the loss is the difference between the amount paid by the victim for the product and the amount for which the victim could resell the product received.<sup>90</sup>

The courts of appeals have made it clear that the Guidelines' insistence on a measurement of net detriment to the victim is not limited to cases involving misrepresentation of the value of goods. As the Tenth Circuit has observed, in determining actual loss, "only net loss is considered; anything received from the defendant in return reduces the actual loss."<sup>91</sup> The sentencing court should calculate "net loss by subtracting the value of what was given to the victim(s) during the course of the transaction from the value of what was fraudulently taken."<sup>92</sup> In *United States v. Barnes*,<sup>93</sup> the Ninth Circuit found the sentencing court erred in failing to consider benefits the defendant provided to a plasma center while fraudulently impersonating a doctor. The court announced that actual loss must be based on the "net detriment to the victim, rather than the gross amount of money that changes hands."<sup>94</sup> The Sixth Circuit has declared, "The [G]uidelines do require the district court to determine the net loss."<sup>95</sup> The Third Circuit held that a defendant convicted of mail fraud for deceiving clients by practicing law without a license must be credited in the loss calculation for the value of satisfactory legal services rendered.<sup>96</sup> The Fifth Circuit has likewise repeatedly endorsed the view that actual loss is net loss to the victim. For example, in *United States v. Sublett*,<sup>97</sup> the court vacated the defendant's sentence in a contracting fraud case where the trial court failed to give the defendant credit against the loss amount for legitimate services he provided or intended to provide. "The district court therefore must deduct the value of the legitimate services actually provided by [defendant's]

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<sup>90</sup> U.S.S.G. § 2F1.1, app. n.8(a) (2000).

<sup>91</sup> *United States v. Haddock*, 12 F.3d 950, 961 (10th Cir. 1993).

<sup>92</sup> *United States v. Pappert*, 112 F.3d 1073, 1079 (10th Cir. 1997).

<sup>93</sup> 125 F.3d 1287, 1290-91 (9th Cir. 1997).

<sup>94</sup> See also *United States v. Harper*, 32 F.3d 1387, 1391 (9th Cir. 1994) (holding actual loss "is a measure of what the victims of the fraud were actually relieved of," or the net loss to the victim; citing *Haddock*, 12 F.3d at 961); *United States v. Williams*, 111 F.3d 139, 1997 WL 187342 (Table) (9th Cir. 1997) (unpublished disposition) ("Consistent with our prior cases, 'actual loss' under the [G]uidelines should be measured as the 'net loss' flowing from the defendant's conduct.").

<sup>95</sup> *United States v. Carroll*, 87 F.3d 1315, 1996 WL 266425 (6th Cir. 1996) (unpublished disposition). See also *United States v. Lavoie*, 19 F.3d 1102, 1105 (6th Cir. 1994); *United States v. Sloman*, 909 F.2d 176, 182 (6th Cir. 1990); *United States v. Kohlbach*, 38 F.3d 832, 840-42 (6th Cir. 1994) (calculating loss, where defendants fraudulently sold adulterated orange juice containing beet sugar instead of pure orange juice concentrate, by subtracting wholesale price of beet sugar from price of orange concentrate, then multiplying by amount of sugar used in the adulterated juice).

<sup>96</sup> *United States v. Maurello*, 76 F.3d 1304, 1311-12 (3d Cir. 1996).

<sup>97</sup> 124 F.3d 693 (5th Cir. 1997).

operation under the first contract and those that he intended to provide under the second contract in its calculation of the loss under section 2F1.1(b)(1).<sup>98</sup>

The same net loss rule is universal in check kiting schemes. The invariable rule is that the proper measurement of loss in a check kiting case is the actual loss to the victim bank as reflected by the amount of the overdraft at the time the kite is detected.<sup>99</sup> A rule that denied credits for money returned to the victim in the course of a kiting scheme would require the sentencing court to add up the face amounts of all the dozens or hundreds of checks that passed through the kited accounts, without subtracting from that gross amount the deposits into the kited accounts. In other words, a 'gross loss' rule would generate an 'actual loss' dozens or hundreds of times larger than the actual amount of money the victim bank really lost. Every court to have considered the issue has rejected such an approach.<sup>100</sup> In short, the prevailing general rule is that actual loss is net loss.

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<sup>98</sup> *Id.* at 695. See also *United States v. Whitlow*, 979 F.2d 1008, 1010-12 (5th Cir. 1992) (holding that the loss incurred by consumers to whom defendant fraudulently sold cars with altered odometers was the price paid by the victim to the defendant less the market value of the vehicles as measured by their resale value). In *United States v. Palmer*, 122 F.3d 215, 222 (5th Cir. 1997), the court upheld the district court's loss calculation against defendant's complaint that court failed to credit him "for the value of products received by the victims, refunds, bounced checks, and stop payment orders." The opinion impliedly conceded that such offsets were proper, but relied on the district court's finding that "the government, which generated the total loss figure, had done its best to exclude such items from its calculations." *Id.* See also *United States v. Peterson*, 101 F.3d 375, 383-84 (5th Cir. 1996) (agreeing with the district court that defendant in stock fraud scheme should be credited with amounts paid to investors as returns, but not with money defendant claimed an intention to repay); *United States v. Krenning*, 93 F.3d 1257, 1269 (5th Cir. 1996) ("the focus of the loss calculation should be on the harm caused to the victim of the fraud," citing with approval, *United States v. Orton*, 73 F.3d 331, 333 (11th Cir. 1996), in which the Eleventh Circuit adopted a net loss approach to determining loss in Ponzi schemes).

<sup>99</sup> See ROGER W. HAINES, JR, ET AL., *FEDERAL SENTENCING GUIDELINES HANDBOOK* 489-91 (WestGroup 2000). The defendant is also entitled to a limited class of immediately available offsets. *United States v. Shaffer*, 35 F.3d 110, 114 (3d Cir. 1994) (holding in check kiting scheme that loss is amount of outstanding bad checks at time of discovery less applicable offsets); *United States v. Flowers*, 55 F.3d 218, 222 (6th Cir. 1995) (finding loss in check kite is the "gross amount of the loss at the time of the detection of the fraud, less funds available for offset, and secured collateral"); *United States v. Marker*, 871 F. Supp. 1404, 1409 (D. Kan. 1994) (same).

<sup>100</sup> For example, in *United States v. Frydenlund*, 990 F.2d 822, 826 (5th Cir. 1993), a case in which a failing auto dealership executed a check kiting scheme in order to stay in business, the Fifth Circuit upheld use of the overdraft amount at the time of detection as the proper loss measurement saying "the sentencing standard depends on the bank's actual loss." In *United States v. Akin*, 62 F.3d 700, 702 (5th Cir. 1995), the court reiterated that "the loss from a check-kiting scheme is the value of the victim's actual loss." Citing *Frydenlund*, the court went on to "reject the argument that actual loss should be calculated at a time other than when the kite is discovered." *Id.* The results in *Akin* and *Frydenlund* are in accord with the view of every other circuit to have considered the issue. See, e.g., *Shaffer*, 35 F.3d at 114; *Flowers*, 55 F.3d at 220-22; *United States v. Mau*, 45 F.3d 212 (7th Cir. 1995) (holding loss in check kiting case measured at time of detection); *Marker*, 871 F. Supp. at 1409 (same).

## 2. The CLC Proposal Endorses a Net Approach to Loss

If loss is to have any meaning as a measurement of economic harm to victims, it must be a measurement of *net* economic deprivation. There is a difference, both in terms of culpability and to the victim's fiscal bottom line, between:

(A) a man who steals my wallet containing \$10,000, and

(B) a man who convinces me to give him \$10,000 in exchange for stock he knows to be worth \$5,000, and

(C) a man who convinces me to give him \$10,000 in exchange for his promise to pay me \$13,000 next Tuesday, but actually pays me only \$8,000 (hoping that this payment will be sufficient to prevent me from going to the police), and

(D) a man who lies about his assets and convinces me to loan him \$10,000 in exchange for an unfulfilled promise to repay the money with interest, collateralized by a security interest in real property worth \$9,000.

In each case, the defendant receives \$10,000 of my money, but (leaving aside considerations of interest) most of us would agree that my loss in the first case is \$10,000, in the second case \$5,000, in the third case \$2,000, and in the fourth case \$1,000. A useful rule on credits against loss must account for these and other commonly occurring situations.

The CLC proposal codifies and makes explicit the existing rule that loss is a net concept. It states as a general rule that loss shall be determined by excluding the value of the economic benefit the defendant or other persons acting jointly with the defendant transferred to the victim before the offense was detected.<sup>101</sup> In addition, the CLC proposal also addresses three specific recurring problems in the area of credits against loss: the problem of investment fraud cases, issues surrounding regulatory offenses and unlicensed professionals, and credits against loss for items of *de minimis* value conveyed to the victim.

### a. Investment Fraud Cases

Courts have adopted three different approaches to credits for amounts returned to the victims of investment schemes with more than one victim (such as so-called 'Ponzi schemes') in which the defendant repays money to early victims in order to continue the scheme or avoid detection. The Second, Fourth, Fifth, and Sixth Circuits have held that payments made to Ponzi scheme victims are not deductible from the loss figure.<sup>102</sup> The theory

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<sup>101</sup> *CLC Draft, infra* App. A, § 2(C)(i).

<sup>102</sup> *United States v. Deavours*, 219 F.3d 400 (5th Cir. 2000); *United States v. Loayza*, 107 F.3d 257 (4th Cir. 1997); *United States v. Carrozzella*, 105 F.3d 796 (2d Cir. 1997); *United States v. Dobbish*, 102 F.3d 760 (6th Cir. 1996); *United States v. Mucciante*, 21 F.3d 1228 (2d Cir. 1994). At one point, the Fifth Circuit seemed to be leaning toward the Eleventh Circuit's 'loss to the losing victims'

of these cases is that a defendant should receive no credit for such payments because they are a necessary part of the scheme designed to gain the investors' confidence in order to secure additional investments and to forestall discovery of the scheme. The Seventh Circuit considers the victims as a class and takes a net loss approach; the loss is the amount taken from the class of victims by the defendant minus the amount given back to the class of victims by the defendant.<sup>103</sup> The Eleventh Circuit has taken a middle ground, adopting a 'loss to the losing investors' approach. Under this theory, the loss is the total amount lost by those victims who were out money at the time of the scheme's discovery. Those investors who received repayments in excess of their original investment are not considered 'victims at all. Therefore, their windfalls are not counted towards reducing the losses of other investors.<sup>104</sup>

The refusal of the Second, Fourth, Fifth, and Sixth Circuits to give credit for any payments to early investors is troublesome even as an interpretation of the current Guidelines. The reasoning of these courts is even less persuasive as a guide to what the law should be. First, giving no credit for repayments runs contrary to the basic 'net loss' approach embodied in section 2F1.1, Application Notes 8(a) and 8(b), as well as the plentiful case law endorsing the net loss approach.<sup>105</sup> Second, as a matter of policy, because the function of the loss figure is to measure economic harm to victims, it must distinguish between greater and lesser harms. A scheme in which a defendant takes and keeps \$10,000 causes more economic harm than one in which the defendant takes \$10,000, but gives back \$5,000.

Third, the rationale for the court-created 'Ponzi scheme exception' to the basic net loss rule—that defendants deserve no credit for payments made solely to perpetuate the scheme—if written into the Guidelines as a caveat to the general rule that 'actual loss' is a net concept, would swallow the general rule and eliminate virtually all credits.<sup>106</sup> No defendant truly bent on fraud confers benefits on his victims out of benevolence or a sense of sound commercial ethics. Any swindler who can do so will steal without incurring any overhead. Thus, almost all payments and transfers by defendants to victims are made in some sense to further the success of the scheme. Consider the four examples from the preceding section. Assume

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approach, see *United States v. Krenning*, 93 F.3d 1257, 1269 (5th Cir. 1996) ("the focus of the loss calculation should be on the harm caused to the victim of the fraud," citing with approval, *United States v. Orton*, 73 F.3d 331, 333 (11th Cir. 1996)), but *Deavours* took a difference course.

<sup>103</sup> *United States v. Holiusa*, 13 F.3d 1043, 1045-46 (7th Cir. 1994).

<sup>104</sup> *United States v. Orton*, 73 F.3d 331 (11th Cir. 1996).

<sup>105</sup> See *supra* notes 90-91 and accompanying text.

<sup>106</sup> The tendency of these investment cases to erode the general net loss principle can be seen in *United States v. Blitz*, 151 F.3d 1002, 1012 (9th Cir. 1998), in which the court denied defendant telemarketers credit for pre-detection refunds and other payments to victims on the ground that such payments were merely necessary incidents to the execution of the scheme. The court equated such payments with defendants' payment of their phone bills. *Id.*

in each case that the defendant's purpose throughout was to steal. The defendant who steals my wallet with \$10,000 in it, of course, gets no credit because he gave nothing back. The defendant who gave me stock he knew to be worth only \$5,000 in return for my \$10,000 would, under a 'perpetuation' rule, get no credit for the \$5,000 because the purpose of giving it to me was to convince me to part with my money and to avoid criminal prosecution by giving me something of arguable economic value. Likewise, neither the defendant who made a partial payment of \$8,000 in order to dissuade me from going to the police, nor the defendant who pledged \$9,000 in collateral to obtain the loan, would be credited. In each case, the defendant gave me money or property in order to convince me to part with my own or to forestall apprehension and punishment. Consequently, a 'perpetuation exception' has the effect of wiping out the general principle that loss is a net concept, and therefore the effect of treating identically cases in which the economic harm to the victims is incontestably quite different. In investment fraud schemes as elsewhere, the difference in harm caused should be reflected in the sentence imposed.<sup>107</sup>

The Seventh Circuit's approach of considering the net loss to the victim investors as a class is likewise questionable because windfalls bestowed on early investors in a Ponzi scheme do nothing to reduce the harm inflicted on later investors left holding the bag. The CLC is convinced that

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<sup>107</sup> The 2001 Staff Draft suggests (though it does not propose specific language for) a 'perpetuation rule' drawn to prohibit credits against loss in which the repayment is made in order to lure additional 'investments' in the scheme. *2001 Staff Draft, supra* note 11, § 2(C)(iii)(e) [Option 2] (emphasis added). The word 'additional' is presumably inserted to limit the exclusion to cases in which repayments are made for the purpose of causing new losses, as distinct from preventing or delaying official detection of old ones. Even with this modest limitation, the resulting rule remains objectionable.

First, although a narrow perpetuation rule would not apply in some fraud cases in which the defendant steals from a single victim in a single fraudulent transaction, it would effectively wipe out the net loss concept in most multi-victim frauds. As a class, economic criminals want to (a) avoid detection, (b) keep stealing as long as they can, and (c) pay as little to the victims and keep as much for themselves as they can get away with. Thus, virtually by definition, transfers of value to victims in ongoing schemes will be designed in large measure to keep the scheme going. Therefore, under even a 'narrow' perpetuation rule, limited to cases in which repayment was made to secure additional sums, virtually no victim repayments in multi-victim schemes would be subtracted from loss. Defendant A, who took \$10,000 from five people, but repaid \$5,000 in the hope of 'perpetuating the scheme' and securing additional investments, would receive the same sentence as Defendant B, who took \$10,000 and repaid nothing, regardless of whether Defendant A received any additional investments followed the repayment. Such a result amounts to abandonment of the idea that loss equates to economic harm.

Second, my generalizations in the preceding paragraph about defendants' motives would, of course, be hotly disputed by the defendants themselves at sentencing. Consequently, the proposed rule would force trial courts into making, in virtually every multi-victim case, difficult determinations about the defendant's 'real' subjective motivations for the repayments (i.e., did the defendant make payments because he was remorseful, because he wanted to escape detection, because he was a businessman who was drawn into fraud by financial reverses which he hoped to make good through illegal speculation, or because he was an incorrigible con man who simply wanted to prolong a lucrative scam?). Not only would the necessity of such determinations complicate sentencing proceedings, but the potential for sentencing disparity between similarly situated defendants is immense. Any "perpetuation rule" should be rejected.

the Eleventh Circuit's 'loss to the losing victims' approach to multi-victim fraud schemes represents the most sensible approach to the loss measurement problem in investment cases. Accordingly, the CLC loss definition provides:

In a case involving a fraudulent investment scheme, such as a 'Ponzi scheme,' the loss shall not be reduced by the value of the economic benefit transferred to any investor in the scheme in excess of that investor's principal investment (i.e., the gain to one investor in the scheme shall not be used to offset the loss to another investor in the scheme).<sup>108</sup>

### b. Regulatory Offenses and Unlicensed Professionals

Some of the knottiest problems presented by the net vs. gross loss debate are illustrated by cases in which defendants evaded FDA regulatory processes in bringing drugs to market. In one case, *United States v. Chatterji*, the defendant provided false information to the FDA to gain approval of a drug.<sup>109</sup> In another, *United States v. Haas*, the defendant purchased drugs in Mexico for sale in the U.S., thus bypassing FDA controls.<sup>110</sup> In both cases, the defendant sold drugs that were equally effective as those approved by the FDA. However, in *Chatterji*, the Fourth Circuit found no economic harm and therefore no loss,<sup>111</sup> while in *Haas*, the Fifth Circuit found no economic harm, but sentenced the defendant based on his gain. A similar problem was presented in *United States v. Maurello*, where the Third Circuit held that a defendant convicted of mail fraud for deceiving clients by practicing law without a license must be credited in the loss calculation for the value of satisfactory legal services rendered.<sup>112</sup>

Some observers, notably including the Justice Department, have been concerned that those who place consumers at risk by evading regulatory processes for drugs and other products and services should receive significant sentences. The drafters of the CLC proposal concluded that the best solution to the problem of evasion of regulatory controls would be a narrowly targeted exception to the crediting rule under which loss would, by definition, include "services fraudulently rendered to victims by persons falsely posing as licensed professionals, or goods falsely represented as approved by a governmental regulatory agency, or goods for which regu-

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<sup>108</sup> CLC Draft, *infra* App. A, § 2(C)(ii).

<sup>109</sup> 46 F.3d 1336 (4th Cir. 1995).

<sup>110</sup> 171 F.3d 259 (5th Cir. 1999).

<sup>111</sup> Although in a later case involving nearly identical facts, *United States v. Marcus*, 82 F.3d 606 (4th Cir. 1996), the Fourth Circuit found the loss to be the value of the gross sales of an unapproved drug, distinguishing *Chatterji* on the ground that the modifications of the drug formula in *Marcus* affected the bioequivalence of the drug.

<sup>112</sup> 76 F.3d 1304, 1311-12 (3d Cir. 1996).

latory approval by a government agency was obtained by fraud.”<sup>113</sup>

From a theoretical perspective, where Congress creates a regulatory authority to regulate risky activities such as the production of medicine, and a defendant intentionally circumvents that authority to make a profit, the fact that the defendant lucked out and did not hurt or kill anybody does not reduce the severity of the crime (or if it does, not by much). Consumers are entitled to rely on the regulatory process. They would not, as a rule, purchase products known to have been produced in defiance of regulatory safeguards. Thus, the entire amount paid for the improperly certified item is indeed a loss because it measures the out-of-pocket expense to fraudulently misinformed consumers. Alternatively, if we consider that the victims of the conduct include the defendant’s competitors—companies that produce equivalent products in conformity with regulatory standards—the value of the defendant’s sales is a fair measure of the loss to the defendant’s competitors. The same arguments can fairly be made in cases involving unlicensed professionals.

The proposed rule for measuring loss in the regulatory arena also solves a technical problem in the area of ‘gain.’ The Department of Justice (DOJ) has in the past pressed for an extension of the concept of gain to deal with regulatory cases such as these. That solution to the regulatory crime problem would have a much greater distorting effect on the overall structure of the loss definition than would this targeted provision for regulatory and unlicensed professional cases. The CLC proposal addresses legitimate concerns about imposing appropriate punishment for regulatory crimes without introducing the unpredictable complications that might well ensue from elevating gain to equal footing with loss as a measure of offense seriousness.<sup>114</sup>

### c. Items of *De Minimis* Value

Over the last several years, DOJ has repeatedly expressed concern about any rule that would require the court to credit defendants for the nearly worthless items sent by telemarketers in place of the items promised. For example, \$5 plastic radios in place of the promised “stereo system,” common coins in place of the promised “rare collectibles,” etc. The

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<sup>113</sup> *CLC Draft, infra* App. A, § 2(C)(i)(b).

<sup>114</sup> Actually, if properly applied, the valuation and time-of measurement provisions of the CLC proposal account for the unapproved drug cases. *CLC Draft, infra* App. A, §§ 2(E)(i), 2(D). Under the CLC proposal, if a defendant sells \$10,000 worth of an unapproved drug or a drug for which approval was fraudulently obtained, the loss to consumers is to be measured at the time of detection of the fraud. *Id.* Once the misrepresentations are exposed at the time of detection, the market value of the drug in the United States is zero (it cannot be sold legally), and thus the loss is the difference between zero and the sum paid by consumers—that is, the entire \$10,000. Nonetheless, a special provision emphasizing that this is the proper result does no harm and gives assurance on the point to those who may feel the need of it.



Department is understandably concerned about two points: (1) that the substituted product confers no real economic benefit on the persons receiving it, and thus should not reduce a defendant's punishment, and (2) that calculating the value of the substituted product is, at best, a nuisance.

In response to DOJ concerns, Commission staff inserted language in the 2001 Staff Draft that would exclude from loss anything transferred to victims by defendants if the thing "has little or no value to the victim because it is substantially different from what the victim intended to receive."<sup>115</sup> As phrased, this exclusion has the potential to become a Trojan horse undermining uniform application of the net loss concept. The problem is the emphasis on whether the economic benefit conferred is of little or no value "to the victim because it is *substantially different from what the victim intended to receive*."<sup>116</sup> In every fraud case, what the victim got was "substantially different from what the victim intended to receive." If the victim got what he intended to receive, there would be no crime. And in many (perhaps most) cases, victims, if asked, will say that what they got is of little or no value to them because it was not what they bargained for, even if the thing transferred had substantial, measurable economic value. The effect of including this provision as written would be to shift the focus of the loss determination from an objective consideration of the market value of whatever the defendant gave the victims to a subjective evaluation of what *the victim thinks* is the value of what the defendant gave him.

No doubt many judges would read such a provision in the spirit it was intended and apply it only rarely. One suspects, however, that a good many others would be predisposed to apply it broadly to include in loss even defendant-to-victim transfers of real objective economic value. At a minimum, this predictable divergence in interpretation would complicate loss calculations and create unjustifiable disparity between similarly-situated defendants. Any advantage such a rule would confer in the narrow class of telemarketing cases would be heavily outweighed by the real risk of more general confusion and disparity.

The CLC proposal takes account of DOJ concerns, but avoids the problems presented by the Commission staff language. It declines to credit defendants for "items of *de minimis* value transferred by the defendant to the victim(s)."<sup>117</sup>

### 3. Summary of the CLC Proposal on Crediting

The CLC proposal provides a simple, clean crediting rule that codifies the basic principle that loss is a net concept that measures economic harm

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<sup>115</sup> 2001 Staff Draft, *supra* note 11, § 2(C)(iii)(d)(1).

<sup>116</sup> *Id.* (emphasis added).

<sup>117</sup> CLC Draft, *infra* App. A, § 2(C)(i)(A).

to the victim, and contains no qualification for payments to victims to “perpetuate the scheme.” The proposal provides no credit to defendants for items of *de minimis* value transferred to victims as part of the scheme. In addition, the CLC proposal includes a targeted provision clarifying loss measurement in two classes of cases—regulatory fraud and unlicensed professional services—that have given particular concern to courts and prosecutors. This proposal is consistent with first principles and should simplify application of the new loss definition.

#### 4. Time of Measurement

Critical to any coherent and workable definition of loss are rules for determining *when* loss should be measured. The time-of-measurement problem actually has two basic components. The first is the question of when to *value* the worth of stolen assets whose value fluctuates over time, such as stock, precious metals, coins, commodities, real estate, and the like. The second is when to *count* so-called “credits” against loss, such as transfers to victims as part of the scheme, repayments to victims, and posted collateral. The most common counting question is whether to reduce the loss amount by the value of things returned or conveyed to the victim after the crime has been detected. This second component of the time-of-measurement problem also has a sub-issue, in that there must be a rule for when to *value* those things *counted* as credits.

For example, assume that a telemarketer sells and delivers to the victim, stock falsely represented to be worth \$1,000, which is, at the time of the sale, actually worth \$300. The victim pays the telemarketer by giving him a quantity of gold, then valued at \$1,000. Assume further that, after the fraud is detected, the telemarketer sends the victim a check for \$700. And assume still further that the true market value of the stock has dropped to \$200 as of the date of detection the fraud, but climbs up to \$400 by the time of sentencing. In the meantime, the value of the gold increases to \$1,100 at the time of detection, but has dropped to \$900 by sentencing day. Useful time-of-measurement rules must tell a sentencing judge: (a) when to value the gold of which the victim was swindled; (b) whether to reduce the amount of the loss by the value of the stock initially transferred to the victim; (c) if so, when to value the stock transferred to the victim; and (d) whether to reduce the amount of the loss by the amount of the \$700 check.

In theory, the loss could be measured (and its constituent elements counted and valued) at any one of a number of points, including the time the crime is legally complete, the time of detection, or the time of sentencing. Moreover, one could envision time-of-measurement rules that counted the components of loss at one time, but valued them at another.

For example, the May 1999 Staff Draft dealt with the crediting problem by *counting* as credits against loss only those transfers from defendants to victims made prior to detection, but *valuing* the things transferred to the victims as of the time of transfer.<sup>118</sup> Similarly, the 2001 Staff Draft now proposes as one option counting *and* valuing credits at the time of detection, while “measuring” (which suggests both counting and valuing) loss generally at the time of sentencing.<sup>119</sup> At present, the CLC position is that, to the extent possible, all the elements of the loss calculation should be counted and valued at the same point in time. The prevailing view is that, although there may be reasons to deviate in special cases from this principle, the greater the number of exceptions, the greater the potential for confusion. In the view of the CLC, the most desirable point at which to measure loss is the time of detection.

In the first place, the time to count “credits” against loss is the time of detection. If defendants were credited with repayments made after detection, but before sentencing, the rich (or those who had not yet spent their criminal earnings) could buy themselves out of prison time.<sup>120</sup> The universal rule now prevailing among those courts to have considered the question is that credits against loss such as transfers to victims, pledges of collateral, and repayments will be measured at the time of detection.<sup>121</sup>

Second, it is equally clear that credits should not be valued prior to detection. As noted above, previous staff drafts had suggested that things of value transferred by a defendant to a victim and credited against loss should be valued at the *time of transfer*.<sup>122</sup> Valuing credits at the time of transfer to the victim would prove terribly cumbersome in many multi-victim or multi-transaction cases, and would produce substantively erroneous and unfair results in certain cases. Consider the following examples:

(A) *Precious metals / rare coins boiler room*: The defendants sell over the telephone to hundreds of victims supposedly “rare” coins or ingots of precious metals at vastly inflated prices. The defendants do send coins to the victims, and the coins have some value. However, the value of the

<sup>118</sup> See *May 1999 Draft*, *supra* note 8.

<sup>119</sup> See *2001 Staff Draft*, *supra* note 11, §§ 2(C)(iii), 2(C)(iii)(b), and 2(B) (Option 1).

<sup>120</sup> See, e.g., *United States v. Wright*, 60 F.3d 240 (6th Cir. 1995).

<sup>121</sup> See, e.g., *United States v. Fraza*, 106 F.3d 1050 (1st Cir. 1997) (holding loss is amount of fraudulent loan not repaid at time offense was discovered); *United States v. Shaffer*, 35 F.3d 110 (3d Cir. 1994) (time for determining loss is time crime is detected); *United States v. Bolden*, 889 F.2d 1336 (4th Cir. 1989) (same); *United States v. Akin*, 62 F.3d 700, 701 (5th Cir. 1995) (rejecting argument of check kiting defendant that the loss figure should be reduced by restitution payments made between time of discovery of kite and sentencing, and holding loss to be measured at time of discovery of scheme); *United States v. Frydenlund*, 990 F.2d 822 (5th Cir.), *cert. denied*, 114 S.Ct. 337, 126 L.Ed.2d 281 (1993) (rejecting argument that check kiting should be treated like fraudulently obtained loan and instead measuring loss at time of discovery of scheme); *United States v. Flowers*, 55 F.3d 218, 220-22 (6th Cir. 1995) (holding in check kiting scheme that loss is to be amount of outstanding bad checks, less any amount in accounts at time of discovery).

<sup>122</sup> See, e.g., *Field Test*, *supra* note 6; *May 1999 Draft*, *supra* note 8.

coins is much less than represented *and* the value fluctuates over time. In such a case, the Commission staff's May 1999 time-of-measurement rule would have required the court to determine the date of every "transfer" of coins, and determine the value of the coins for every date on which a transfer occurred. In a routine boiler room case, this would involve hundreds or even thousands of different valuations.

(B) *Stock fraud*: Defendant makes an initial stock offering in the penny stock market, and makes inflated and untrue claims in the prospectus. Hundreds of victims buy the stock over a six-month period, during which time the stock steadily gains in value. At the end of the six-month period, the defendant's falsehoods come to light and the value of the stock plunges to zero. In such a case, not only would the May 1999 "valuation at time of transfer" rule require the court to determine the fluctuating price of the bogus stock on every date on which there was a purchase, but it would produce the absurd result that *the victims would be found to have no loss at all*. Since the amount of money the victims paid to the defendant would be offset by a credit for the market value of the stock *on the date of transfer*, by definition the loss would be zero.

Similar phenomena occur in real estate schemes in which defendants succeed in inflating the market value of otherwise undesirable property. In all such schemes, measuring the value of the thing transferred to the victim at the time of transfer produces a loss of zero. The only way around this result is to argue that the "real" value of the transferred property at the time of the transfer was not its then-current market price, but the value it would have had if full information had been available. But this is nothing more than a roundabout way of saying that the value of transferred property in such cases is actually its value at the time of detection of the crime. So why not adopt that rule in the first place?

The arguments just expressed have proven persuasive to both the CLC and the Commission staff, and thus the views of the CLC and the Commission staff on when to count and value credits are now in accord.

The knottier question remains when to measure loss more generally, or to put it another way, when to count and value those components of loss not involving credits. The argument favoring the CLC position that loss should be measured at the time of detection may be summarized in this way: in the first place, time-of-detection makes the best sense as the moment at which to "freeze the action" for purposes of measurement. Once a crime is discovered by its victims, they can take steps to prevent further losses. Likewise, once a crime is detected, defendants will ordinarily stop their criminal behavior, either because they have been arrested or because they fear arrest and do not wish to make their punishment worse. Thus, in the ordinary case, the time of detection will be the point of maximum

loss.<sup>123</sup> Additionally, even though losses may sometimes continue to accrue after detection up until sentencing despite the cessation of a defendant's active criminal efforts, there is far too great a potential for arbitrariness in measuring loss at the date of sentencing. For example, defendants should not have to spend more time in prison because losses mount while the government or the court delays a prosecution or sentencing.<sup>124</sup>

Nonetheless, a case can be made for counting and valuing the "non-credit" components of loss at the time of sentencing. In the first place, there is at least some potential tension between a time-of-detection measurement rule and the basic definition of loss as "reasonably foreseeable pecuniary harm that resulted or will result" from the defendant's conduct.<sup>125</sup> Presumably, some of the harms that fall within this definition will not manifest themselves until some time after the moment the crime is detected. Moreover, one could argue that the valuation problem would be made somewhat simpler because probation officers and other experts preparing for sentencing could look to current market values of assets, as opposed to ascertaining those values at the earlier time of detection. However, I confess to finding the valuation argument unconvincing, as I doubt that in most cases valuing assets on a past date certain would prove any more difficult than providing a current market value.

The 2001 Staff Draft offers two options for time-of-measurement: first, that loss should be measured at the time of sentencing (Option 1), or second, that loss should be measured at the time the offense was detected (Option 2).<sup>126</sup> The CLC has proposed the following time of measurement rules:

*Time of measurement:* Loss should ordinarily be measured at the time the offense was detected.

- (i) For purposes of this guideline, an offense is detected when the defendant knew or reasonably should have known that the offense was detected by a victim or a public law enforcement agency.

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<sup>123</sup> Of course, if a defendant persisted in committing additional criminal conduct leading to new losses after detection of the scheme, this rule would not cut off his sentencing liability for the new losses because the additional conduct would not yet have been "detected" for purposes of the rule.

<sup>124</sup> See, e.g., *United States v. Stanley*, 54 F.3d 103, 106 (2d Cir. 1995). In *Stanley*, a bank trust officer bought bonds at high price for trust clients of bank. As the bonds began to devalue, the officer misstated their value in bank records and in statements sent to clients. Hence, neither bank nor clients could act to sell and stem losses. The *Stanley* court found loss was the amount of devaluation in the period between when the misstatements were made to the bank and customers, and when the fraud was discovered. *Id.*

<sup>125</sup> *CLC Draft, infra* App. A, § 2A; *2001 Staff Draft, supra* note 11, § 2A.

<sup>126</sup> *2001 Staff Draft, supra* note 11, § 2(B).

(ii) Except as provided in subsection (D)(iii), the value of any "economic benefit" transferred to the victim by the defendant for purposes of Subsection (C) shall be measured at the time the offense was detected.

(iii) However, in a case involving collateral pledged by a defendant, the "economic benefit" of such collateral to the victim for purposes of Subsection (C) is the amount the victim has recovered at the time of sentencing from disposition of the collateral. If the collateral has not been disposed of by that time, the "economic benefit" of the collateral is its value at the time of sentencing.<sup>127</sup>

These rules embody the principle that, in general, all components of loss should be measured at the time of detection. This means that the money or property obtained by the defendant from the victim, *and* the money or property transferred back to the victim from the defendant during the course of the scheme should all be counted and valued as of the date of detection. The only exception to this general rule is the valuation of pledged collateral. At present, such collateral is valued at either the amount obtained by the victim through foreclosure and liquidation, or if these events have not yet occurred by sentencing, at the fair market value at the time of sentencing.<sup>128</sup> For reasons of ease of administration and continuity with existing practice, the CLC proposal retains this limited exception to the general timing rule.

## 5. The Problem of Gain

I have been arguing for several years that a separate provision addressing a defendant's gain is superfluous in a properly drafted loss guideline because gain is unnecessary if the victims of defendant's conduct are accurately identified.<sup>129</sup> Although I continue to think this is true in almost all cases, cases do exist in which calculation of loss on a victim-by-victim basis is impracticable, but calculation of defendant's gain is readily achievable and represents a reasonable approximation of the harm to the victims as a class. Therefore, it makes good sense to make gain available as a means of approximating loss in such cases. The CLC proposal treats gain in just this way, stating that: "*The court shall use the defendant's gain as an alternative measure of loss when loss cannot otherwise reasonably be determined, but the defendant's gain can reasonably be determined.*"<sup>130</sup>

The CLC proposal correctly rejects the approach of several staff drafts that propose using gain "instead of"<sup>131</sup> or as "an alternative measure

<sup>127</sup> CLC Draft, *infra* App. A, § 2D.

<sup>128</sup> See HAINES & WOLL, *supra* note 30, at 484-88.

<sup>129</sup> See Bowman, *supra* note 14, at 508.

<sup>130</sup> CLC Draft, *infra* App. A, § 2F.

<sup>131</sup> See May 1999 Draft, *supra* note 8.

of”<sup>132</sup> loss where “gain is greater than loss and more accurately reflects the seriousness of the offense.”<sup>133</sup> This approach has both theoretical and practical problems. First, it is highly unlikely that gain will be truly greater than loss. It is difficult to imagine how this could ever occur. If a defendant’s gain is simply the value of the money or property the defendant gets from the victim without any reduction for the defendant’s costs, then gain exactly equals loss. If, as several participants in the loss debate have suggested, the gain calculation should be net gain, that is the amount the defendant retained from the crime after his expenses, then gain is, by definition, less than loss. All undertakings, even purely criminal ones, have some overhead costs. Moreover, all of the proposals currently under consideration—the April 1998 draft, the May 1999 draft, the 2001 Staff Draft, and the CLC proposal—define loss as including reasonably foreseeable pecuniary harms suffered by the victim in consequence of the defendant’s criminal conduct. Such foreseeable harms may make loss larger than gain, because loss will include economic deprivations to the victims that do not necessarily benefit the defendant. However, under these proposals a defendant’s pecuniary gain will never be larger than the pecuniary loss.

Second, using gain as loss in a case where gain exceeds loss (assuming that it could) gives gain an independent significance. There is no theoretical problem with using gain as an alternate measure of loss when defendant’s gain is known to be less than the victims’ loss, but the loss is itself difficult to determine with specificity. In such a case, we are merely conceding that we cannot as a practical matter discover the entire loss, and so are content with using gain to establish a reliable minimum loss figure to use in setting a sentence. However, if gain can indeed exceed loss and the court can set a sentence based on gain instead of on loss, the court would be punishing the defendant, not for the harm he had done anyone else, but for the benefit he had obtained for himself.

Assume two cases. Defendant A steals \$100 from Mr. Victim, as a result of which he somehow “gains” \$1,000. Defendant B simply steals \$1,000 from Mr. Victim. The rule proposed by Commission staff would punish Defendant A equally with Defendant B, even though Defendant B stole *ten times* as much money from and caused ten times as much economic harm to Mr. Victim. There is no justification either in criminal law theory, or in common sense, for such a result.

#### F. *Intended Loss*

Intended loss is a decent proxy measurement of a defendant’s culpability in uncompleted or partially uncompleted economic offenses. The

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<sup>132</sup> 2001 Staff Draft, *supra* note 11, § 2(D)(5) (Option 2).

<sup>133</sup> See May 1999 Draft, *supra* note 8.

CLC proposal embodies the view that the proper rule on intended loss is the current one—that loss should be the greater of the actual loss or intended loss.<sup>134</sup> By contrast, in its May 1999 draft, the staff suggested as “Option 2” that loss be defined as either “the sum of actual loss and any additional intended loss” or “the sum of actual loss and any intended loss not resulting in actual loss.”<sup>135</sup> While the CLC understood and appreciated the staff’s thinking, it was unpersuaded by it.

There are certainly cases in which the defendant desired to cause pecuniary harm in addition to the actual harm which his conduct did indeed cause. But the vast majority of such cases are already accounted for by the present rule. Consider, for example, a defendant who intends to defraud his victims of \$100,000, but only succeeds in getting away with \$50,000 before being caught. In such a case, the staff proposal would add the \$50,000 actually stolen to the additional \$50,000 the defendant wanted to steal, but couldn’t, and get a loss of \$100,000. But present rule dictates the identical result because the \$100,000 loss the defendant intended *already includes* the \$50,000 the defendant succeeded in stealing. The staff’s proposal was an attempt to address those cases in which (1) a defendant intends to cause a loss in addition to the actual loss, and (2) the actual loss figure includes economic harms reasonably foreseeable to the defendant, but not specifically intended by him. There are no doubt some such cases. There is reason to doubt, however, that they are sufficiently common to make it worthwhile to complicate the definition of loss. Happily, the 2001 Staff Draft is now in accord with the CLC proposal.<sup>136</sup>

## CONCLUSION

Hopefully, readers will find the foregoing analysis useful. The project of revising the loss definition has been ongoing since 1995, and has drawn on the energy and talents of hundreds of lawyers, judges, past and present Commissioners, and members of the Commission staff. It appears we are very close to bringing this long project to successful fruition. The CLC proposal incorporates the best work of many people, and is the best that has so far been advanced. The Commission should act this spring to adopt a reform measure very close to what the CLC has proposed.

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<sup>134</sup> Neither the current Guidelines nor any of the pending proposals amplify the meaning of the word “intended.” Drawing on general criminal law principles, it is fair to conclude that the intended loss is the harm the defendant either desired to cause or was practically certain would result from his offense. Whether any language making this point explicit should be included in the Guidelines remains an open question.

<sup>135</sup> *May 1999 Draft*, *supra* note 8.

<sup>136</sup> *2001 Staff Draft*, *supra* note 11, § 2A.



## APPENDIX A

## CLC PROPOSED 2001 DRAFT DEFINITION OF LOSS

In the Commentary to sections 2B1.1 and 2F1.1 captioned “Application Notes” insert after Note 1 the following new Note 2:

2. *For purposes of subsection (b)(1):*

(A) *General Rule. Loss is the greater of the actual loss or the intended loss.*

*“Actual loss” means the reasonably foreseeable pecuniary harm that resulted or will result from the conduct for which the defendant is accountable under § 1B1.3 (Relevant Conduct).*

*“Reasonably foreseeable pecuniary harm” means pecuniary harm that the defendant knew or, under the circumstances of the particular case, reasonably should have known likely would result in the ordinary course of events from the conduct for which the defendant is accountable under § 1B1.3 (Relevant Conduct).*

*“Intended loss” means the pecuniary harm that was intended to result from the conduct for which the defendant is accountable under § 1B1.3, even if that harm would have been impossible or unlikely to occur (e.g., as in a government sting operation, or an intended insurance fraud in which the claim exceeded the insured value), so long as the intended loss would reasonably have resulted if the facts were as the defendant believed them to be.*

(B) *Exclusions from Loss. Loss does not include the following:*

(i) *Interest of any kind, finance charges, late fees, penalties, anticipated profits, or amounts based on an agreed-upon return or rate of return.*

(ii) *Costs to the government of, and costs incurred by victims primarily to aid the government in, the prosecution and criminal investigation of an offense, even if such costs are reasonably foreseeable.*

(C) *Credits In Determining Loss.*

- (i) *Loss shall be determined by excluding the value of the economic benefit the defendant or other persons acting jointly with the defendant transferred to the victim before the offense was detected. However, loss shall not be reduced by the value of:*
    - (a) *benefits of de minimis value transferred by the defendant to the victim(s).*
    - (b) *services fraudulently rendered to victims by persons falsely posing as licensed professionals, or goods falsely represented as approved by a governmental regulatory agency, or goods for which regulatory approval by a government agency was obtained by fraud.*
  - (ii) *In a case involving a fraudulent investment scheme, such as a "Ponzi scheme," the loss shall not be reduced by the value of the economic benefit transferred to any investor in the scheme in excess of that investor's principal investment (i.e., the gain to one investor in the scheme shall not be used to offset the loss to another investor in the scheme).*
  - (iii) *For purposes of this subsection: (A) "economic benefit" means money, property, or services performed; and (B) "transferred" includes pledged or otherwise provided as collateral, returned, repaid, or otherwise conveyed.*
- (D) *Time of measurement: Loss should ordinarily be measured at the time the offense was detected.*
- (i) *For purposes of this guideline, an offense is detected when the defendant knew or reasonably should have known that the offense was detected by a victim or a public law enforcement agency.*
  - (ii) *Except as provided in subsection (D)(iii), the value of any "economic benefit" transferred to the victim by the defendant for purposes of Subsection (C) shall be measured at the time the offense was detected.*
  - (iii) *However, in a case involving collateral pledged by a defendant, the "economic benefit" of such collateral to the victim for purposes of Subsection (C) is the amount the victim has*

*recovered at the time of sentencing from disposition of the collateral. If the collateral has not been disposed of by that time, the “economic benefit” of the collateral is its value at the time of sentencing.*

- (E) *Estimation of Loss. The court need not determine the precise amount of the loss. Rather, it need only make a reasonable estimate of loss. The sentencing judge is in a unique position to assess the evidence and estimate the loss based upon that evidence. For this reason, the court’s loss determination is entitled to appropriate deference. See 18 U.S.C. § 3742(e) and (f).*

*The estimate of the loss shall be based on available information, taking into account and using as appropriate and practicable under the circumstances, factors such as the following:*

- (i) *The fair market value of the property, or other thing of value, taken or otherwise unlawfully acquired, misapplied, misappropriated, or destroyed; or if the fair market value is impracticable to determine or inadequately measures the harm, the cost to the victim of replacing that property or other thing of value.*
  - (ii) *The cost of repairs to damaged property, not to exceed the replacement cost had the property been destroyed.*
  - (iii) *The approximate number of victims multiplied by the average loss to each victim.*
  - (iv) *More general factors, such as the scope and duration of the offense and revenues generated by similar operations.*
- (F) *Gain. The court shall use the defendant’s gain as an alternative measure of loss when loss cannot otherwise reasonably be determined, but the defendant’s gain can reasonably be determined.*
- (G) *Special Rules. The following special rules shall be used to assist in determining actual loss in the cases indicated:*

- (i) *Stolen or Counterfeit Credit Cards and Access Devices; Purloined Numbers and Codes. In a case involving stolen or counterfeit credit cards (see 15 U.S.C. § 1602(k)), stolen or*

*counterfeit access devices (see 18 U.S.C. § 1029(e)(1)), or purloined numbers or codes, the actual loss includes any unauthorized charges made with the credit cards, access devices, or numbers or codes. The actual loss determined for each such credit card, access device, number or code shall be not less than \$500.*

- (ii) *Diversion of Government Program Benefits. In a case involving diversion of government program benefits, actual loss is the value of the benefits diverted from intended recipients or uses. For example, if the defendant was the lawful recipient of food stamps having a value of \$100 but fraudulently received food stamps having a value of \$150, the loss is \$50.*
- (iii) *Davis-Bacon Act Cases. In a case involving a Davis-Bacon Act violation (i.e., a violation of 40 U.S.C. § 276a, criminally prosecuted under 18 U.S.C. § 1001), the actual loss is the difference between the legally required and actual wages paid.*

(H) *Departure Considerations.*

- (i) *Upward Departure Considerations. There may be cases in which the loss substantially understates the seriousness of the offense or the culpability of the defendant. In such cases, an upward departure may be warranted. The following is a non-exhaustive list of factors that the court may consider in determining whether an upward departure is warranted:*
  - (a) *A primary objective of the offense was an aggravating, non-monetary objective, such as to inflict emotional harm.*
  - (b) *The offense resulted in or risked substantial non-monetary harm. For example, the offense caused physical harm, psychological harm, or severe emotional trauma, or resulted in a substantial invasion of a privacy interest.*
  - (c) *The offense created a risk of substantial loss beyond the loss determined above.*

- (d) *The offense endangered the solvency or financial security of one or more victims.*
  - (e) *The offense involved a substantial risk that a victim would lose a significant portion of his or her net worth or suffer other significant financial hardship.*
- (ii) *Downward Departure Considerations. There may be cases in which the loss substantially overstates the seriousness of the offense or the culpability of the defendant. In such cases, a downward departure may be warranted. The following is a non-exhaustive list of factors that the court may consider in determining whether a downward departure is warranted:*
- (a) *The primary objective of the offense was a mitigating, non-monetary objective, such as to fund medical treatment for a sick parent. However, if, in addition to that primary objective, a substantial objective of the offense was to benefit the defendant economically, a downward departure for this reason would not ordinarily be warranted.*
  - (b) *The loss significantly exceeds the greater of the defendant's actual or intended personal gain, and therefore significantly overstates the culpability of the defendant.*

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Background:

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*The Commission has determined that, ordinarily, the sentences of defendants convicted of federal offenses should reflect the nature and magnitude of the pecuniary harm caused by their crimes. Accordingly, along with other relevant factors under the guidelines, loss serves as a measure of the seriousness of the offense and the defendant's relative culpability and is a principal factor in determining the offense level under this guideline.*

*Both direct and indirect pecuniary harm that is a reasonably foreseeable result of the offense will be taken into account in determining the loss. For*

*example, in an offense involving unlawfully accessing, or exceeding authorized access to, a "protected computer," as defined in 18 U.S.C. § 1030(e)(2)(A) or (B), "loss" is the reasonably foreseeable pecuniary harm to the victim, which typically includes costs such as conducting a damage assessment and restoring the system and data to their condition prior to the offense. Likewise, in a product substitution case, the loss includes the victim's reasonably foreseeable costs of making substitute transactions and handling or disposing of the product delivered or modifying the product so that it can be used for its intended purpose, plus the victim's reasonably foreseeable cost of correcting the actual or potential disruption to the victim's business caused by the product substitution. Similarly, in a defense contract fraud case, loss includes the reasonably foreseeable administrative cost to the government and other participants of repeating or correcting the procurement action affected, plus any increased cost to procure the product or service involved that was reasonably foreseeable.*

\* \* \*

*[Make all technical and conforming amendments necessary to fully execute this amendment.]*

## APPENDIX B

### CURRENT GUIDELINES PROVISIONS DEFINING "LOSS" FROM U.S.S.G. § 2B1.1 (THEFT OFFENSES), APPLICATION NOTES

2. *"Loss" means the value of the property taken, damaged, or destroyed. Ordinarily, when property is taken or destroyed the loss is the fair market value of the particular property at issue. Where the market value is difficult to ascertain or inadequate to measure harm to the victim, the court may measure loss in some other way, such as reasonable replacement cost to the victim. Loss does not include the interest that could have been earned had the funds not been stolen. When property is damaged, the loss is the cost of repairs, not to exceed the loss had the property been destroyed. Examples: (1) In the case of a theft of a check or money order, the loss is the loss that would have occurred if the check or money order had been cashed. (2) In the case of a defendant apprehended taking a vehicle, the loss is the value of the vehicle even if the vehicle is recovered immediately.*

*Where the offense involved making a fraudulent loan or credit card application, or other unlawful conduct involving a loan or credit*

*card, the loss is to be determined under the principles set forth in the Commentary to § 2F1.1 (Fraud and Deceit).*

*In certain cases, an offense may involve a series of transactions without a corresponding increase in loss. For example, a defendant may embezzle \$5,000 from a bank and conceal this embezzlement by shifting this amount from one account to another in a series of nine transactions over a six-month period. In this example, the loss is \$5,000 (the amount taken), not \$45,000 (the sum of the nine transactions), because the additional transactions did not increase the actual or potential loss.*

*In stolen property offenses (receiving, transporting, transferring, transmitting, or possessing stolen property), the loss is the value of the stolen property determined as in a theft offense.*

*In an offense involving unlawfully accessing, or exceeding authorized access to, a "protected computer" as defined in 18 U.S.C. § 1030(e)(2)(A) or (B), "loss" includes the reasonable cost to the victim of conducting a damage assessment, restoring the system and data to their condition prior to the offense, and any lost revenue due to interruption of service.*

*In the case of a partially completed offense (e.g., an offense involving a completed theft that is part of a larger, attempted theft), the offense level is to be determined in accordance with the provisions of § 2X1.1 (Attempt, Solicitation, or Conspiracy) whether the conviction is for the substantive offense, the inchoate offense (attempt, solicitation, or conspiracy), or both; see Application Note 4 in the Commentary to § 2X1.1.*

- 3. For the purposes of subsection (b)(1), the loss need not be determined with precision. The court need only make a reasonable estimate of the loss, given the available information. This estimate, for example, may be based upon the approximate number of victims and the average loss to each victim, or on more general factors such as the scope and duration of the offense.*
- 4. The loss includes any unauthorized charges made with stolen credit cards, but in no event less than \$100 per card. See Commentary to §§ 2X1.1 (Attempt, Solicitation, or Conspiracy) and 2F1.1 (Fraud and Deceit).*

5. *Controlled substances should be valued at their estimated street value.*

\* \* \*

15. *In cases where the loss determined under subsection (b)(1) does not fully capture the harmfulness of the conduct, an upward departure may be warranted. For example, the theft of personal information or writings (e.g., medical records, educational records, a diary) may involve a substantial invasion of a privacy interest that would not be addressed by the monetary loss provisions of subsection (b)(1).*

\* \* \*

Background: *The value of the property stolen plays an important role in determining sentences for theft and other offenses involving stolen property because it is an indicator of both the harm to the victim and the gain to the defendant. Because of the structure of the Sentencing Table (Chapter 5, Part A), subsection (b)(1) results in an overlapping range of enhancements based on the loss.*

From U.S.S.G. § 2F1.1 (Fraud Offenses), Application Notes

8. *Valuation of loss is discussed in the Commentary to § 2B1.1 (Larceny, Embezzlement, and Other Forms of Theft). As in theft cases, loss is the value of the money, property, or services unlawfully taken; it does not, for example, include interest the victim could have earned on such funds had the offense not occurred. Consistent with the provisions of § 2X1.1 (Attempt, Solicitation, or Conspiracy), if an intended loss that the defendant was attempting to inflict can be determined, this figure will be used if it is greater than the actual loss. Frequently, loss in a fraud case will be the same as in a theft case. For example, if the fraud consisted of selling or attempting to sell \$40,000 in worthless securities, or representing that a forged check for \$40,000 was genuine, the loss would be \$40,000.*

*There are, however, instances where additional factors are to be considered in determining the loss or intended loss:*

(a) *Fraud Involving Misrepresentation of the Value of an Item or Product Substitution*



*A fraud may involve the misrepresentation of the value of an item that does have some value (in contrast to an item that is worthless). Where, for example, a defendant fraudulently represents that stock is worth \$40,000 and the stock is worth only \$10,000, the loss is the amount by which the stock was overvalued (i.e., \$30,000). In a case involving a misrepresentation concerning the quality of a consumer product, the loss is the difference between the amount paid by the victim for the product and the amount for which the victim could resell the product received.*

(b) *Fraudulent Loan Application and Contract Procurement Cases*

*In fraudulent loan application cases and contract procurement cases, the loss is the actual loss to the victim (or if the loss has not yet come about, the expected loss). For example, if a defendant fraudulently obtains a loan by misrepresenting the value of his assets, the loss is the amount of the loan not repaid at the time the offense is discovered, reduced by the amount the lending institution has recovered (or can expect to recover) from any assets pledged to secure the loan. However, where the intended loss is greater than the actual loss, the intended loss is to be used.*

*In some cases, the loss determined above may significantly understate or overstate the seriousness of the defendant's conduct. For example, where the defendant substantially understated his debts to obtain a loan, which he nevertheless repaid, the loss determined above (zero loss) will tend not to reflect adequately the risk of loss created by the defendant's conduct. Conversely, a defendant may understate his debts to a limited degree to obtain a loan (e.g., to expand a grain export business), which he genuinely expected to repay and for which he would have qualified at a higher interest rate had he made truthful disclosure, but he is unable to repay the loan because of some unforeseen event (e.g., an embargo imposed on grain exports) which would have caused a default in any event. In such a case, the loss determined above may overstate the seriousness of the defendant's conduct. Where the loss determined above significantly understates or overstates the seriousness of the defendant's conduct, an upward or downward departure may be warranted.*

(c) *Consequential Damages in Procurement Fraud and Product*

### Substitution Cases

*In contrast to other types of cases, loss in a procurement fraud or product substitution case includes not only direct damages, but also consequential damages that were reasonably foreseeable. For example, in a case involving a defense product substitution offense, the loss includes the government's reasonably foreseeable costs of making substitute transactions and handling or disposing of the product delivered or retrofitting the product so that it can be used for its intended purpose, plus the government's reasonably foreseeable cost of rectifying the actual or potential disruption to government operations caused by the product substitution. Similarly, in the case of fraud affecting a defense contract award, loss includes the reasonably foreseeable administrative cost to the government and other participants of repeating or correcting the procurement action affected, plus any increased cost to procure the product or service involved that was reasonably foreseeable. Inclusion of reasonably foreseeable consequential damages directly in the calculation of loss in procurement fraud and product substitution cases reflects that such damages frequently are substantial in such cases.*

(d) Diversion of Government Program Benefits

*In a case involving diversion of government program benefits, loss is the value of the benefits diverted from intended recipients or uses.*

(e) Davis-Bacon Act Cases

*In a case involving a Davis-Bacon Act violation (a violation of 40 U.S.C. § 276a, criminally prosecuted under 18 U.S.C. § 1001), the loss is the difference between the legally required and actual wages paid.*

9. *For the purposes of subsection (b)(1), the loss need not be determined with precision. The court need only make a reasonable estimate of the loss, given the available information. This estimate, for example, may be based on the approximate number of victims and an estimate of the average loss to each victim, or on more general factors, such as the nature and duration of the fraud and the revenues generated by similar operations. The offender's gain from committing the fraud is an alternative estimate that ordinarily will underestimate the loss.*

\* \* \*

11. *In cases in which the loss determined under subsection (b)(1) does not fully capture the harmfulness and seriousness of the conduct, an upward departure may be warranted. Examples may include the following:*

- (a) a primary objective of the fraud was non-monetary; or the fraud caused or risked reasonably foreseeable, substantial non-monetary harm;*
- (b) false statements were made for the purpose of facilitating some other crime;*
- (c) the offense caused reasonably foreseeable, physical or psychological harm or severe emotional trauma;*
- (d) the offense endangered national security or military readiness;*
- (e) the offense caused a loss of confidence in an important institution;*
- (f) the offense involved the knowing endangerment of the solvency of one or more victims.*

*In a few instances, the loss determined under subsection (b)(1) may overstate the seriousness of the offense. This may occur, for example, where a defendant attempted to negotiate an instrument that was so obviously fraudulent that no one would seriously consider honoring it. In such cases, a downward departure may be warranted.*

12. *Offenses involving fraudulent identification documents and access devices, in violation of 18 U.S.C. §§ 1028 and 1029, are also covered by this guideline. Where the primary purpose of the offense involved the unlawful production, transfer, possession, or use of identification documents for the purpose of violating, or assisting another to violate, the laws relating to naturalization, citizenship, or legal resident status, apply § 2L2.1 or § 2L2.2, as appropriate, rather than § 2F1.1. In the case of an offense involving false identification documents or access devices, an upward departure may be warranted where the actual loss does not adequately reflect the seriousness of the conduct.*

\* \* \*

*Background: This guideline is designed to apply to a wide variety of fraud cases. The statutory maximum term of imprisonment for most such offenses is five years. The guideline does not link offense characteristics to specific code sections. Because federal fraud statutes are so broadly written, a single pattern of offense conduct usually can be prosecuted under several code sections, as a result of which the offense of conviction may be somewhat arbitrary. Furthermore, most fraud statutes cover a broad range of conduct with extreme variation in severity.*

*Empirical analyses of pre-guidelines practice showed that the most important factors that determined sentence length were the amount of loss and whether the offense was an isolated crime of opportunity or was sophisticated or repeated. Accordingly, although they are imperfect, these are the primary factors upon which the guideline has been based.*

