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Briefing Paper on Problems in Redefining "Loss" (U.S. Sentencing Commission Economic Crime Symposium)

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Editor's Note: On October 12–13, 2000, the U.S. Sentencing Commission sponsored its Third Symposium On Crime and Punishment in the United States: Federal Sentencing Policy for Economic Crimes and New Technology Offenses. The afternoon of the first day of the meeting was devoted to discussing the concept of "loss" as a measurement of defendant culpability and offense seriousness. The conferees were divided into small groups to discuss discrete sub-issues relating to "loss" and its place in sentencing economic crimes under the Guidelines. Following the small group discussions, the discussion leaders ("facilitators") addressed a plenary session of the conference to report on the conclusions drawn by their groups. In an effort to capture the essence of an afternoon of wide-ranging discussion, we have reproduced two documents here: first, a condensed version of a briefing paper provided to the small group facilitators by the Sentencing Commission prior to the conference, and second, a transcript of the plenary session at which the facilitators reported the conclusions reached by their groups.

Briefing Paper on Problems In Redefining "Loss"

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This paper begins with a description of the general principles at issue when discussing the place of "loss" in setting punishments for economic crime. It then focuses on the sub-issues assigned to the breakout groups.

I. The Definition and Role of "Loss" Under the Current Guidelines

The amount of "loss" is the primary determinant of a defendant's sentence for economic offenses sentenced under Section 2B1.1 and 2F1.1 of the Guidelines. The root of the "loss" problem is that the Guidelines do not now contain a meaningful definition of the term. The commentary following Sections 2B1.1 and 2F1.1 includes a series of directives which neither singly nor together amount to a coherent definition. In the first place, the basic definition of "loss" – "the value of the property taken, damaged, or destroyed" – uses the language of larceny. The word "taken" is a term of art, denoting the "taking" element of common law larceny, with its insistence on a transfer of possession of moveable personalty. Outside the context of simple larceny-like offenses, this definition is virtually useless. For example, when is property "taken" in a wire fraud or a bankruptcy fraud or an insider trading case, and how, and from whom?

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 an ugly and nearly incomprehensible patchwork, which so far as can be discerned, looks roughly like this:

- The relevant conduct guideline, §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.
- By contrast, both the fraud and theft guidelines define "loss" narrowly as the "thing taken," the corpus delicti of the crime.
- Moreover, §2F1.1, 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. If "consequential damages" is given its customary contract law meaning, Note 8(c) excludes from "loss" even economic harms which were directly caused by defendant's conduct and foreseeable by him at the time he committed the crime.
- On the other hand, in cases of procurement fraud and product substitution, §2F1.1, Note 8(c), specifically includes in "loss" the "consequential damages" elsewhere excluded, if the loss is "foreseeable."
- Likewise, under the relevant conduct rules, §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.
- In loan fraud cases, pursuant to §2F1.1, Note 8(b), the loss to banks caused by a drop in value of pledged collateral between the making of the loan and the date of sentencing is a part of the "loss," regardless of whether decline was foreseeable and despite the fact that such a loss is a classic "consequential damage."

In short, in place of a coherent definition, the Guidelines present a jumble of rules about what loss means in particular situations.

II. Breakout Groups 1 and 2: Arriving at a Core Definition of Actual Loss—Causation and Related Issues

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 Federal Sentencing 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."

The "loss" figure is designed to serve as the primary measure 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. 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, however, it is fair to say that "loss" is, first and foremost, a quantitative measurement of the pecuniary *harm* the defendant either caused or intended.

A. Causation

In general, stealing more is worse than stealing less, and should be punished more severely. 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, in general, a successful scheme to steal a large amount involves longer planning and premeditation. Therefore, in completed offenses, a larger "loss" should, in general, be punished more severely than a smaller "loss."

This simple equivalency becomes more complex, however, in cases where the defendant's criminal conduct caused economic harms which the defendant did not desire, or from which he did not personally benefit. For example, a defendant in a fraudulent loan application case, confident 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 loss of retirement savings to the telemarketer. In these and 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. Cause-in-fact is about determining the causal relationship between a defendant's act and a subsequent harm to another. 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? 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 and social policy, 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." To a certain extent, the familiar reasonable foreseeability standard mushes together 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 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 through the relevant conduct guideline, § 1B1.3, and by inclusion of the contracts term "consequential damages"in Section 2F1.1, Note 8(c). For the past several years, the Sentencing Commission, in consultation with outside groups such as the Judicial Conference, the Justice Department, and the defense bar has been working on a redefinition of actual loss that would be cause-based. This redefinition would contain a causation standard for actual loss under the Guidelines expressing 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.

B. Questions on Causation for Groups One and Two

1. Should the core definition of "loss" be based on principles of causation?

The first question for Groups One and Two is whether the core definition of "loss" in completed economic crimes should be cause-based, and if so, whether the standard should be reasonable foreseeability. Facilitators may wish to explore whether some alternative non-causation-based definition of actual loss would be feasible and desirable. Likewise, facilitators might wish to consider whether standards of causation either narrower or broader than reasonable foreseeability would be more desirable. For example, one might eliminate the legal cause component of the definition altogether and hold defendants responsible for all harms that would not have occurred but for their criminal conduct, regardless of whether those harms were foreseeable to the defendant. Conversely, one might decide to hold a defendant responsible only for those harms that he intended and that were caused in fact by his criminal conduct.

In discussing the issue of causation, facilitators may also wish to consider that it is possible to limit legal liability for harms, not only by changing the standard of legal cause (e.g., tightening the definition of "foreseeability"), but also by imposing a stricter than "but for" definition of cause-in-fact. One can, for example, require that the defendant's harm be a "substantial factor" in causing the harm, rather than merely one factor contributing to causing the harm.[1]

Second, facilitators in Groups 1 and 2 may wish to consider whether actual loss should be limited to pecuniary harms caused by defendants' misconduct, or whether non-economic harms such as emotional distress should be "monetized" and included in loss. That is, should courts attempt to assign monetary values to non-economic harms caused by economic crimes (as courts and juries do routinely in civil lawsuits) and include the resulting figures in loss?

Finally, Groups 1 and 2 will doubtless wish to address the question of whether a reasonable foreseeability standard for actual loss would sweep too broadly. Would such a standard include within "loss" harms for which a defendant ought not be punished? Would such a standard confer desirable discretion on district court judges to determine the harms that ought and ought not be considered for sentencing purposes? Or would it require hearings on issues tangential to the core concerns of sentencing? In considering these questions, facilitators in Groups 1 and 2 may wish to address the issues raised by the phrase "consequential damages" that now appears in the fraud loss definition. Some have argued that the general exclusion of "consequential damages" from loss in Application Note 8 is desirable because it limits the scope of actual loss to the harms most directly connected to a defendant's misconduct. Others have contended that the interjection of a term drawn from contract law into a rule of criminal sentencing is, at the very least, extraordinarily confusing. Moreover, if the term "consequential damages" is given its normal legal meaning, excluding such "damages" from loss means excluding harms that were caused in fact by the defendant and were entirely foreseeable to the defendant.[2] Facilitators may wish to discuss whether some of the concerns about overbreadth of a cause-based loss definition can be addressed by special rules expressly excluding from "loss" certain commonly occurring foreseeable harms – such as interest and the costs to the government of investigating the crime.

2. Should interest be included in the amount of "loss"?

The question of whether interest should be included in the "loss" amount is a special instance of the general causation problem. The Guidelines now exclude interest from "loss."

Application Note 8 to §2F1.1 says that loss "does not ... include interest the victim could have earned on such funds had the offense not occurred." Nonetheless, several 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.[3] There are three possible approaches to dealing with interest: (1) exclude all interest, including both bargained-for and opportunity cost interest, (2) include interest or some other measure of the time value of the money or property stolen from the victim in all cases, or (3) include "bargained for" interest, but exclude all other interest and opportunity costs.

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 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 going 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.

As noted above, several 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, so-called "bargained-for interest." Objections to the position of these courts include:

First, "loss" is 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 10% 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.

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 50% 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.

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. And, 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 have to make findings about exactly what was promised each of perhaps dozens or hundreds of victims.

One 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 eucres a victim out of $1,000 by falsely promising a 10% monthly return is by no rational calculation either more or less blameworthy than another crook who inveigles the same victim into parting with the same $1,000 with a false promise of a 15% 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 makes in his efforts to do so. In short, it has been argued that among the competing proposals regarding interest, the "bargained for" interest option is the least desirable of the lot.

b. Arguments for total exclusion of interest

One can argue that interest should be excluded from "loss" altogether. Including interest introduces all the problems of equity between defendants and complexity of calculation just discussed, but it does little to make "loss" a more accurate measure of relative offense seriousness. In the view of those who favor a total exclusion of interest, it is difficult to see 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.

Another argument in favor of excluding both "interest" and opportunity costs from loss is that such an exclusion goes some distance toward meeting a central objection to defining "loss" in terms of causation – that doing so may result in including too many peripheral economic harms. Excluding all interest and opportunity costs, as well as the government's investigative costs, would eliminate many of the peripheral harms that would be likely to cause dispute and delay in the sentencing process.

3. Group 2: Do problems of multiple causation need to be addressed in a loss definition?

The issue of multiple causation commonly arises when a defendant's conduct has plainly caused some actual loss to the victim, but the defense claims the loss would have been smaller or nonexistent but for the intervention of factors unforeseen by the defendant. Consider, for example, a victim who purchases stock based on a defendant's fraudulent misrepresentations about the value of the stock, and then sees the stock decrease in value still further because of an unforeseen downturn in the stock market after the purchase. From one point of view, the only loss directly caused by the defendant in this case is the difference between the price the victim paid for the stock based on the representations by the defendant and the actual (lower) market value of the stock at the time of purchase.[4] On the other hand, *but for* the defendant's blandishments, the victim would not have been holding the stock to begin with and thus would not have suffered the additional harm caused by the market decline. The fundamental issue is the nature and strength of the required causal nexus between a defendant's criminal conduct and the "loss" charged to him under the guidelines.

The Guidelines now provide somewhat conflicting advice on how this problem should be approached. The only direct reference to the issue of multiple causation in either the theft or fraud guidelines is in Application Note 8(b) of §2F1.1. There it is suggested that the amount of "loss" which was caused by the defendant's conduct may overstate the seriousness of his offense if there existed some cause or causes extraneous to the defendant's misbehavior. The example given is an unanticipated economic event like a grain embargo. In such a case, the suggested remedy is a downward departure.

By contrast, the very same Application Note 8(b) says that loss in fraudulent loan cases will be determined by taking the unpaid balance of the loan at the time of discovery of the fraud and subtracting the amount the "lending institution has recovered (or can expect to recover)" from liquidation of the collateral. The commentary does not exclude from the loss calculation the increase in "loss" which necessarily occurs any time the value of pledged collateral has decreased due to changed market conditions, natural disasters, or other factors arising between the making of the loan and the liquidation of the collateral after discovery of the fraud. Where the victim is a bank, the defendant is responsible for the bank's *whole* loss, multiple factors or no.

No guidance is given on the question of when losses arising from external factors should be attributed to the defendant and when the connection between the external factor, the defendant's conduct, and the victim's loss is so attenuated that some adjustment should be made by actual modification of the loss amount or by departure. Courts have wrestled with this problem with indifferent success. Some appear to recognize that adjustments to "loss" for multiple causation may be appropriate in certain cases.[5] On the other hand, the Third Circuit is of the view that multiple causation can only be a ground for a downward departure.[6]

Group 2 may wish to discuss whether a core definition of actual loss based on reasonable foreseeability resolves the question of how to deal with multiple causation, or whether some additional provision specifically dealing with cases of multiple causation is desirable.

III. Breakout Groups 3, 4, & 5: Is "loss" a gross or net concept? If net, what crediting rules should be adopted?

A. "Net" vs. "Gross" Loss: The Problem of Credits Against Loss

1. Current law

Under current law, the general rule is that actual loss under §2F1.1 is the net loss to the victim. The fraud guideline requires that any loss suffered by a fraud victim be offset by any value received in the transaction. Application Note 8(a) to §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 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 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.

The courts have made 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."[7]

The same net loss rule applies in check kiting schemes. The proper measurement of "loss" in a check kiting case is the actual loss to the victim bank measured at the time the kite is detected. A rule denying "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 the deposits into the kited accounts. In short, 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. The courts have uniformly rejected such an approach.[8]

The prevailing general rule is that actual loss is net loss. However, some courts have been reluctant to reduce loss in theft or embezzlement cases where a defendant completed the offense and deprived the victim of money or property, but returned some or all of the money or property before the offense was discovered.[9] More commonly, disputes have arisen in fraud cases over whether in some circumstances the value of money or property conveyed to victims as part of the fraudulent scheme should be deducted from the loss amount.

2. Net vs. gross loss

Groups 3, 4, and 5 should address the basic question of whether loss is a net or gross concept. If "loss" is primarily a measurement of economic harm to victims, it seems hard to escape the conclusion that loss should measure the *net* economic deprivation of the victim(s). However, facilitators may wish to explore whether this conclusion is really so compelling as it seems. In assessing the desirability of the current general rule, one might consider whether there is a difference, both in terms of culpability and of the victim's fiscal bottom line, between:

(i) a man who steals my wallet containing $10,000;
(ii) a man who convinces me to give him $10,000 in exchange for stock he knows to be worth $5,000;

(iii) 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

(iv) 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 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. How should a rule on loss and credits against loss account for these and other commonly occurring situations?

B. Group 3: Regulatory crimes

Some of the knottiest problems presented by the net versus 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*,[10] the defendant provided false information to the FDA to gain approval of a drug. In another, *United States v. Haas*,[11] the defendant purchased drugs in Mexico for sale in the U.S., thus bypassing FDA controls. 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,[12] 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*,[13] 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.

Some observers are of the view that those who place consumers at risk by evading regulatory processes for drugs and other products and services should receive significant sentences. The difficulty is that the "loss" mechanism for measuring offense seriousness does not account very well for economic and non-economic harm (such as physical injury or illness that might result from taking inefficacious unapproved drugs) that is *risked*, but does not actually occur. Group 3 may wish to explore questions such as:

- Did the consumers in the drug and professional services cases suffer any "loss," in the sense of a quantifiable economic harm?
- Was the government or the public the true victim of this conduct? How should any injury to the government or the public be accounted for? Is the "loss" mechanism the best way of doing so? Ought cases of this type to be sentenced under a separate guideline?
- Should the guidelines treat risk of harm as equivalent to actual harm? Should a risk be treated more seriously where a defendant consciously evaded regulatory controls created precisely for the purpose of reducing that risk?
- Could these cases be sentenced within the fraud guideline by employing the defendants' "gain" as a substitute measure for "loss"? Or would using gain in these cases distort the fraud guidelines?

C. Group 4: Crediting rules in investment fraud cases and for items of de minimis value

1. 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. Four circuits have held that payments made to Ponzi scheme victims are not deductible from the "loss" figure at all.[14] The theory 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.[15] 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.

The position of those courts that refuse to give credit for any payments to early investors is troublesome on both interpretive and policy grounds. First, giving no credit for repayments seems to run contrary to the basic "net loss" approach endorsed by § 2F1.1, Application Notes 8(a) and 8(b). Second, 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 this exception to the basic net loss rule – that defendants deserve no credit for payments made solely to perpetuate the scheme – when taken to its logical conclusion would swallow the rule and eliminate virtually all credits. 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 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. Nonetheless, a defendant who steals $50,000 and gives nothing in return causes a greater social harm than one who takes $50,000, but gives back $40,000. It would seem that in investment fraud schemes as elsewhere, the difference in harm caused should be reflected in the sentence imposed.

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 Eleventh Circuit's "loss to the losing victims" approach to multi-victim fraud schemes may represent the most sensible approach to the loss measurement problem in investment cases.

2. Items of "little or no value" because "substantially different" than the thing promised

In its May 1999 draft of a proposed loss redefinition, the Commission staff proposed excluding from "loss" things transferred to victims by defendants if the thing "has little or no value to the victim because it is substantially different from what the defendant or persons acting jointly with the defendant led the victim to expect." This proposal had its genesis in Justice Department concerns about the nearly worthless items sent by telemarketers in place of the items promised — $5 plastic radios in place of the promised "stereo system," common coins in place of the "rare collectibles" promised, etc. The Department was understandably concerned about two points: (1) that such junk 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 stuff is, at best, a nuisance. Facilitators in Group 4 may wish to explore whether some exclusion from credits against loss for items of de minimis value is appropriate, and if so, how such an exclusion should be phrased.

D. Group 5: Time of Measurement

Critical to any coherent and workable definition of "loss" is a rule for determining *when* loss should be measured. The timing of the loss measurement may be crucial in determining the value of the "thing taken" if its value fluctuates. Timing rules are essential in deciding how to measure loss from a continuing and complex course of conduct like a check kite. Likewise, the time of measurement will influence whether credits against loss will be given for payments or repayments to victims. In theory, "loss" could be measured 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.

The argument in favor of a time-of-detection rule (which seems to have been adopted by the majority of circuits for at least some kinds of cases[16]) can be summarized as follows: 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. 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. 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. Conversely, defendants should not have to spend more time in prison because losses mount while the government or the court delays a prosecution or sentencing.

It is also critical that rules governing when loss should be measured provide coherent guidance about when so-called "credits" against loss (such as victim repayments and posted collateral) are to be valued. The importance, and the difficulties, of drafting a good time of measurement rule for credit are illustrated by a proposal now on the table in the May 1999 Sentencing Commission staff draft loss redefinition.[17] This draft would seem to require that: (a) loss be measured at the *time of detection*, but (b) that the value of collateral to be credited against loss be valued *when liquidated* or at the *time of sentencing*, whichever came first, and (c) that all other things of value transferred by a defendant to a victim and credited against loss be valued at the *time of transfer*. It can fairly be argued that the May 1999 Draft violates the principle that a good time-of-measurement rule should – with the absolute minimum number of exceptions – provide for measuring the value of what the defendant stole *and* the value of any credits against that value *at the same point in time*.

Moreover, valuing credits at the time of transfer to the victim might well: (a) prove terribly cumbersome in many multi-victim or multi-transaction cases, and (b) produce substantively erroneous and unfair results in certain cases. Consider, for example, a defendant who 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 proposed "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.

The only way around this zero-loss 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?

Group 5 may also wish to discuss 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. There are those who argue that ease of administration and continuity with existing practice, should result in retaining this limited exception to the general timing rule.

IV. Groups 6 and 7: Intended Loss & Gain

A. Partially complete or inchoate offenses (attempts, conspiracies, and the like)

Under current Guidelines, actual loss is the primary measurement of offense seriousness for completed economic crimes. It does not, however, assist in ranking offense seriousness for economic crimes which are either wholly or partially incomplete, such as attempts or unsuccessful conspiracies. If a defendant conspires to steal or defraud, but is caught in the act, an economic crime guideline that measured only actual loss could not differentiate between a scheme to steal $1 million and a scheme to shoplift a box of candy bars.

The present Guidelines rank the seriousness of inchoate economic crimes by focusing on a defendant's intent and providing that the "loss" figure used in calculating the offense level will be the greater of the actual *or intended* harm. Groups 6 and 7 should consider whether the intended loss measurement should be retained in order to facilitate the ranking of wholly inchoate or partially uncompleted crimes. In addition, the following sub-issues arise:

1. What about intended loss that is factually impossible or improbable?

There is a difference of opinion as to whether the intended loss must be realistic. This question arises in two types of cases – those involving government "sting" operations where no loss was possible because the defendant was dealing with government agents, and those in which the defendant's objectives were either impossible or improbable for some other, usually economic, reason. Facilitators should considers two types of cases.

"Sting operations": Defendants caught by government undercover operations before they can steal any money commonly argue that the intended loss provision of § 2F1.1, Note 8, should not apply to them because no actual loss was possible. The majority of the circuits to have addressed the question reject this argument and treat fraud cases no differently than drug cases or other "stings" in which success is foreclosed by the defendant's choice of confederate.[18] The Tenth Circuit, however, has taken a different view, holding that where the defendant is dealing with a government agent and no money changes hands, there is no loss.[19]

Economic reality: Some courts require the court to determine whether it was realistically possible for defendant to inflict the intended loss.[20] This position has been characterized as the "economic reality" doctrine.[21] The majority of courts hold that it does not matter whether the intended loss was realistically possible.[22] However, the Seventh Circuit has suggested that the improbability of an intended loss might be a proper basis for a downward departure.[23]

2. Should intended loss count less than actual loss?

Ordinarily, the criminal law punishes defendants less severely for uncompleted crime and unconsumated harms than for completed crime and harms actually inflicted. For example, sentences for attempt crimes are customarily, if not invariably, less serious than sentences for the same completed offenses. As now structured, the Guidelines give the same weight to intended loss as it does to actual loss. Facilitators in Group 6 should consider how, if at all, the Guidelines should "discount" intended loss as against actual loss.

B. Group 7: The problem of "gain"

It has been argued that the concept of "gain" is superfluous in a properly drafted loss guideline because "gain" is unnecessary if the victims of defendant's conduct are accurately identified.[24] Even if this is generally true, 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 may be desirable to make gain available as a means of approximating loss in such cases. Facilitators in Group 7 should discuss the desirability of the use of gain for this purpose.

It has also been suggested, as for example in the May 1999 draft, that gain should be used *"instead of* loss" where "gain is greater than loss and more accurately reflects the seriousness of the offense." This approach presents several difficulties. First, it is difficult to imagine a case in which gain was actually greater than loss. 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," 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 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 sets 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. It is difficult to identify a justification either in criminal law theory, or in common sense, for such a result.

Notes

1 *See* Frank O. Bowman, III, *Coping With "Loss": A Re-Examination of Sentencing Federal Economic Crimes Under the Guidelines*, 51 VAND. L. R. 461, 530–31 (1998).

2 *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE, § 10–4, at 564 (4th ed. 1995) (defining "consequential damages" to include damages resulting from contractual breach that were foreseeable to breaching party); 5 A. CORBIN, CORBIN ON CONTRACTS § 1010, at 79 (1964) (same).

3 *See United States v. Gilberg*, 75 F.3d 15 (1st Cir. 1996); *United States v. Henderson*, 19 F.3d 917, 928 (5th Cir. 1994); *United States v. Jones*, 933 F.2d 353, 354–55 (6th Cir. 1991); *cf., United States v. Moored*, 38 F.3d 1419, 1423 (6th Cir. 1994) (stating in dictum that loss does *not* include interest); *United States v. Porter*, 145 F.3d 897 (7th Cir. 1998). 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).

4 *See* U.S.S.G. §2F1.1, note 8(a) (2000).

5 *See, e.g., United States v. Bennett*, 60 F.3d 902, 905 (1st Cir. 1995); *United States v. Rostoff*, 53 F.3d 398, 405 (1st Cir. 1995); *United States v. Irons*, 53 F.3d 947, 949 (8th Cir. 1995).

6 *United States v. Neadle*, 72 F.3d 1104, 1110 (3d Cir. 1995), reh'g *denied*, (1996), *and cert. denied*, 117 S.Ct. 238 (1996), *citing United States v. Kopp*, 951 F.2d 521, 531 (3d Cir. 1991) *reh'g denied* (1991).

7 *United States v. Haddock*, 12 F.3d 950, 961 (10th Cir. 1993). *See also, United States v. Pappert*, 112 F.3d 1073, 1079 (10th Cir. 1997); *United States v. Barnes*, 125 F.3d 1287, 1290–91 (9th Cir. 1997) (actual loss must be based on "net detriment to the victim, rather than the gross amount of money that changes hands"); *United States v. Harper*, 32 F.3d 1387, 1391 (9th Cir. 1994); *United States v. Williams*, 111 F.3d 139 (Table), 1997 WL 187342 (9th Cir. 1997); *United States v. Carroll*, 87 F.3d 1315, 1996 WL 266425 (6th Cir. 1996) (unpublished disposition) ("The guidelines do require the district court to determine the net loss."); *United States v. Lavoie*, 19 F.3d 1102, 1105 (6th Cir.1994); *United States v. Sublett*, 124 F.3d 693, 694 (5th Cir. 1997).

8 *See, e.g.,United States v. Frydenlund*, 990 F.2d 822, 826 (5th Cir. 1993); *United States v. Akin*, 62 F.3d 700, 702 (5th Cir. 1995); *United States v. Shaffer*, 35 F.3d 110, 114 (3d Cir. 1994); *United States v. Flowers*, 55 F.3d 218, 220–22 (6th Cir. 1995); *United States v. Mau*, 45 F.3d 212 (7th Cir. 1995).

9 *See, e.g., United States v. Mount*, 966 F.2d 262, 265 (7th Cir. 1992).

10 46 F.3d 1336 (4th Cir. 1995).

11 171 F.3d 259 (5th Cir. 1999).

12 *Cf., United States v. Marcus* , 82 F.3d 606 (4th Cir. 1996)(holding loss was value of gross sales of an unapproved drug, distinguishing *Chatterji*).

13 76 F.3d 1304, 1311–12 (3d Cir. 1996)

14 *United States v. Carrozzella*, 105 F.3d 796 (2d Cir. 1997); *United States v. Loayza*, 107 F.3d 257 (4th Cir. 1997); *United States v. Deavours*, 219 F.3d 400 (5th Cir. 2000); *United States v. Dobish*, 102 F.3d 760 (6th Cir. 1996).

15 *United States v. Holiusa*, 13 F.3d 1043, 1045–46 (7th Cir. 1994), 13 F.3d 1043 (7th Cir. 1994).

16 *See* Bowman, *supra* note 1, at 542–45.

17 The text of the May 1999 draft appears in this edition of FSR at 13 FED. SENT. REP 47 (2001).

18 *See, e.g., United States v. Robinson*, 94 F.3d 1325, 1329 (9th Cir. 1996); *United States v. Falcioni*, 45 F.3d 24, 27 (2d Cir. 1995); *United States v. Studevent*, 116 F.3d 1559, 1561 (D.C. Cir. 1997).

19 *United States v. Galbraith*, 20 F.3d 1054, 1058–1060 (10th Cir. 1994). *See also, United States v. Sneed*, 34 F.3d 1570 (10th Cir. 1994).

20 *See, e.g., United States v. Ensminger*, 174 F.3d 1143 (10th Cir. 1999); United States v. Watkins, 994 F.2d 1192 (6th Cir. 1993); *United States v. Dozie*, 27 F.3d 95 (4th Cir. 1994); *United States v. Sung*, 51 F.3d 92, 95 (7th Cir. 1995).

21 *See* John D. Cline, *Should the Sentencing Commission Adopt the Economic Reality Doctrine?*, 10 FED. SENT. RPTR. 141 (Nov/Dec 1997).

22 *See* ROGER W. HAINES, JR, FRANK O. BOWMAN, III & JENNIFER WOLL, FEDERAL SENTENCING GUIDELINES HANDBOOK 472 n. 178 (West 2000) (collecting cases).

23 *United States v. Stockheimer*, 157 F.3d 1082 (7th Cir. 1998).

24 *See*, Bowman, *supra* note 1, at 508.