
**A FIELD TEST OF PROPOSED REVISIONS
TO THE DEFINITION OF LOSS IN THE
THEFT AND FRAUD GUIDELINES**

A Report to the Commission



UNITED STATES SENTENCING COMMISSION

October 20, 1998

INTRODUCTION

For two years, the United States Sentencing Commission has been considering possible amendments to the guidelines that cover economic crimes. One of the issues central to this inquiry has been the definition of “loss” in the theft and fraud guidelines.¹ The amount of loss is one of the most important factors in determining the sentence in such cases.

In the spring of 1998, the Commission considered a comprehensive economic crimes amendment package that included a new definition of loss. (A copy of the proposed definition is attached as Appendix A.) Although the amendment package failed to pass, the Commission resolved to explore the pros and cons of the proposed loss definition by working with the Criminal Law Committee of the Judicial Conference to test how the proposed definition works when applied to real-world cases.

Accordingly, in July and August of 1998, twenty-two federal judges and twenty-one probation officers were surveyed in a field test of the proposed definition of loss. Each judge was given the proposed definition and asked to apply it, with the assistance of a probation officer, to seven randomly selected theft and fraud cases that had been sentenced during the previous two years. These randomly selected cases provided a basis for estimating how often the various features of the proposed definition would arise in practice. In addition, judges on the Criminal Law Committee were asked to apply the definition to cases of their own choosing. These participant-selected cases allowed us to assess how the definition worked in cases that are viewed as particularly troublesome or interesting. Judges completed survey instruments on a total of 121 randomly selected and 107 participant-selected cases.

Each judge and probation officer also was asked to complete a Summary Evaluation Form, which sought overall impressions of the proposed definition. The field test also included a Hypothetical Loss Scenario (attached as Appendix B), designed both to illustrate key issues in the determination of loss under the proposed definition and to measure consistency in interpretation of important terms, such as “reasonably foreseeable pecuniary harm,” “intended loss,” “gain,” and “credits.” Finally, when all their cases were received and the preliminary results of the field test were known, the participants were invited to attend a full-day Debriefing Session on September 16, 1998, at which the Commission presented its findings and solicited more input.

The results of the field test allow us to assess the proposed loss definition along three dimensions. First, is the guideline language clear in defining how the loss determination should be made? Are there ambiguous phrases or overly complex rules? Second, is the definition workable in practice? Are the factual findings required by the definition reasonable? Will the necessary information be available, or will needlessly protracted investigations or sentencing hearings be required? Third, are the results it produces appropriate? Do the amounts included or excluded

¹U.S.S.G. §§2B1.1 (theft), 2F1.1 (fraud).

under the definition properly identify the amounts that *should* be the basis for a defendant's offense level under the guidelines?

Part I of this report summarizes the participants' views along these three dimensions of clarity, workability, and appropriateness. We describe differences between the proposed and current definitions and report participants' overall impressions of the proposal and of areas where it might be improved further. In part II of the report we turn to particular issues that warrant more detailed scrutiny. Variations in the application of the new definition to the Hypothetical Loss Scenario are reported, and examples of problematic cases identified through the field test are presented.

I. EVALUATING THE PROPOSED DEFINITION

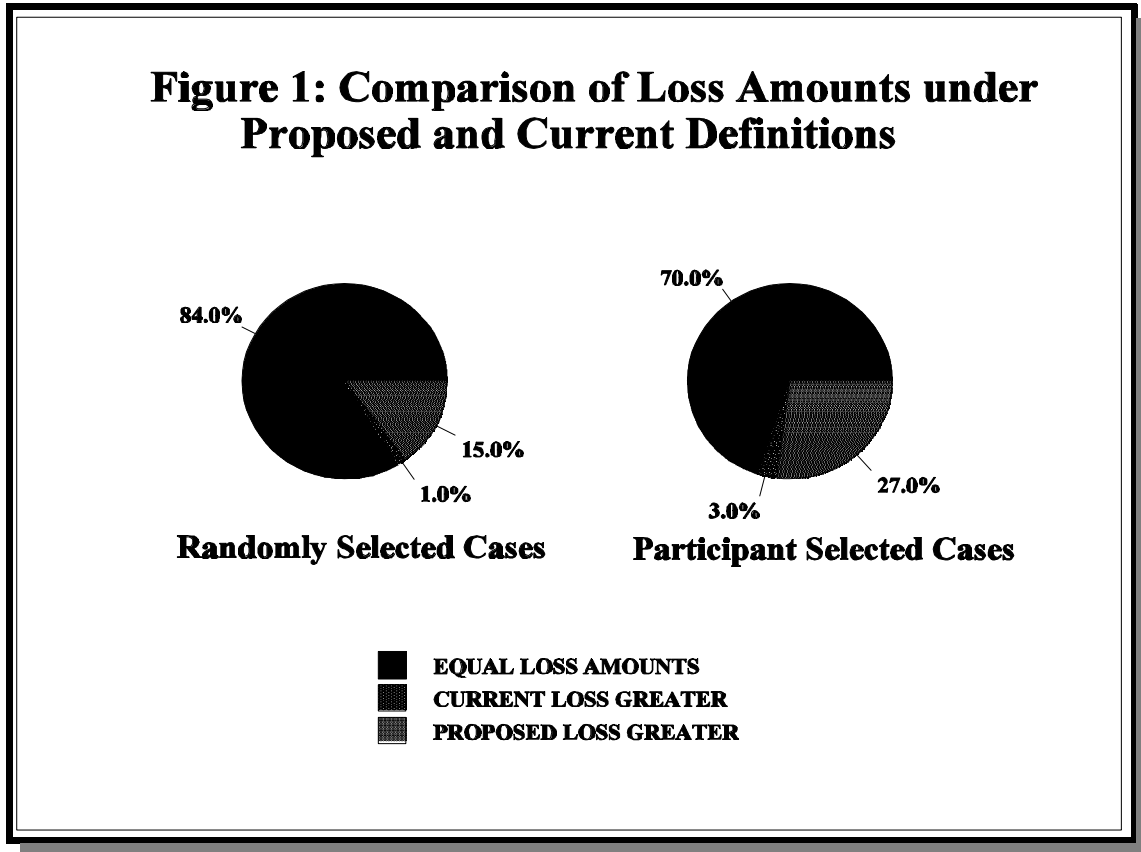
A. Differences Between the Current and Proposed Definitions

The proposed definition differs from the current definition in several significant ways. First, it is unified and reorganized for clarity; the current definition is split primarily between the theft and fraud guidelines. Second, it provides a core definition of "actual loss" that incorporates all "reasonably foreseeable pecuniary harm," in contrast to the current definition, which focuses on "the value of the property taken, damaged, or destroyed" without providing an explicit causation standard. Third, it defines "intended loss" in the beginning of the definition and highlights the current directive to use the intended loss figure when it is higher than the actual loss figure. Fourth, it changes the rule on credits against loss to make credits applicable to all cases. Finally, it amends the current rules on interest, gain, and credit cards, potentially settles several circuit splits, and provides a united list of encouraged departures.

Despite these changes, in 84 percent of the random cases in our sample the proposed definition produced the same loss amount as was used in the original sentencing under the current rules (see Figure 1).² This suggests that the proposed definition would have little effect in most cases. Of course, other factors might account for this finding as well. For example, in some cases the presentence report may not have contained the information necessary to apply all provisions of the proposed definition. In others, the parties may have stipulated to an amount that did not actually represent what the loss was under the current definition, an inconsistency that could affect our results. Finally, the margin of error associated with a sample of this size (about plus or minus five percent), and the fact that only a small fraction of all federal judges and districts

²The selected cases were also examined and the majority (70%) of them also yielded the same results under both definitions. The participant-selected cases may have been chosen in part because they were more likely than typical cases to be affected by the change in definition. Because the findings based on the random cases are more representative of the results expected if the proposal were applied to the entire caseload in participating districts, they are reported whenever such generalizations are appropriate.

participated in the study, further qualifies our findings. Nonetheless, one may reasonably infer that the change in definition would not affect the loss determination in most cases, these caveats notwithstanding.



In those cases in which the loss determination was affected, the proposed definition almost always increased the loss amount compared to the current definition. In 15 percent of the randomly selected cases, the loss amount was greater under the proposed definition than it was in the original case³; in contrast, the loss amount was less in just one percent. Participants rarely gave a reason for the increase in loss amount, but when they did the concept of “reasonably foreseeable pecuniary harms” was most frequently cited. The proposed credits rule was the only basis cited for a reduction in the loss amount.

³On closer inspection, it appears that the proposed definition itself accounted for the increase in just two thirds of this 15 percent of cases. In the other one third, some other factor — most likely a stipulation in a plea agreement in the original case — was responsible for the increase. In other words, in the latter one third of cases the loss amount might have been the same under both definitions if the original case had not been governed by a plea agreement.

B. Clarity of the Proposed Definition

Both judges and probation officers generally found the proposed definition to be “logically organized and easy to follow.” Two judges and one probation officer indicated otherwise. Improved ease of use, rather than substantive effect on loss determinations, may be the most notable result of adopting the proposal.

This is not to say that participants saw no need for further improvements to the proposed definition. Several suggested that additional detail in the definition or illustrative examples might be helpful. Problem areas cited by more than one participant in Part I of the Summary Evaluation Form included:

- # “Reasonably foreseeable pecuniary harm” is vague and in need of further explanation and examples, particularly regarding whether it includes victims’ expenses from investigating the offense, obtaining legal counsel, or attending court proceedings.
- # The limits of intended loss are unclear — does it include all the actual losses, and all the potential losses in ongoing, incomplete, or widespread crimes?
- # The reference to §2X1.1, involving incomplete crimes or speculative intended losses, is complicated and confusing.
- # The definition of “gain” is inadequate.

Participants were asked to indicate, from a list provided, the factors that needed “further clarification or additional application instructions” in a particular case. Table 1 displays the percent of the random cases in which a judge cited a particular factor as unclear.⁴

Table 1: Percent of Cases in which Various Factors Require Clarification

Loss Issue	Percent
Actual Loss	10%
Reasonably Foreseeable Pecuniary Harm	12%
Intended Loss	21%
Gain	1%

C. Workability of the Proposed Definition

Because the field test used cases that had previously been sentenced, loss determinations had to be based on existing presentence reports. This limited to some extent our ability to test the

⁴Only factors that are relevant to all cases are listed.

availability of the information needed to apply the proposed definition. However, participants were asked to indicate in the Individual Case Worksheets which features of the proposed definition, if any, “required information that would be impracticable to obtain in this case.” Table 2 displays the percent of cases in which judges indicated a factor might be unworkable in practice.

Table 2: Percent of Cases in which Various Factors Require Information that is Impracticable to Obtain

Issue	Percent of Cases
Actual Loss	8%
Reasonably Foreseeable Pecuniary Harm	7%
Intended Loss	18%
Gain	14%

In the Summary Evaluation Form, judges and probation officers were asked “For what kind(s) of cases or factual scenarios, if any, was it difficult to use the proposed definition?” A number of respondents indicated that calculating intended loss was problematic in a variety of scenarios. They often cited the difficulty of determining a precise loss figure in ongoing schemes that end only because of detection by law enforcement, as well as in cases involving multiple victims. In telemarketing or large-scale investment schemes in particular, respondents found it difficult to account for losses to all the victims. One probation officer suggested adopting a standard method that would calculate aggregate loss based on the average loss in a random sample of victims.

Similarly, calculations using the proposed definition became laborious in complex loan cases that involved multiple loan transactions and various types of collateral. Other aspects of the definition that proved unworkable included determining the limits of “reasonably foreseeable.” Questions were also raised about how to handle cases in which the loss amount had been settled in a plea agreement.

D. Appropriateness of the Proposed Definition

The Summary Evaluation Form asked participants “which definition produces the more appropriate and responsible results.” The near-universal consensus among both judges and probation officers was that the proposed definition was preferable to the current formulation. Among the 16 judges answering this question, 13 preferred the proposed definition. One judge

preferred the current definition, one said there was no difference, and one was unsure. Only one of the twelve probation officers who completed Summary Evaluation Forms preferred the current definition, and one liked neither.

Reasons given by judges for preferring the proposed definition included:

- # A unified definition is better.
- # A more precise measure of loss should help reduce disparity.
- # The definition is clear, clean, and less speculative than the current definition.
- # For the few difficult cases, the proposed definition would be helpful.
- # It makes the defendant responsible for criminal intent, despite the unlikelihood of harm, and includes indirect harms and non-immediate damages.
- # The encouraged departures for multiple victims and extraordinary restitution are good.
- # It gives judges departure options.

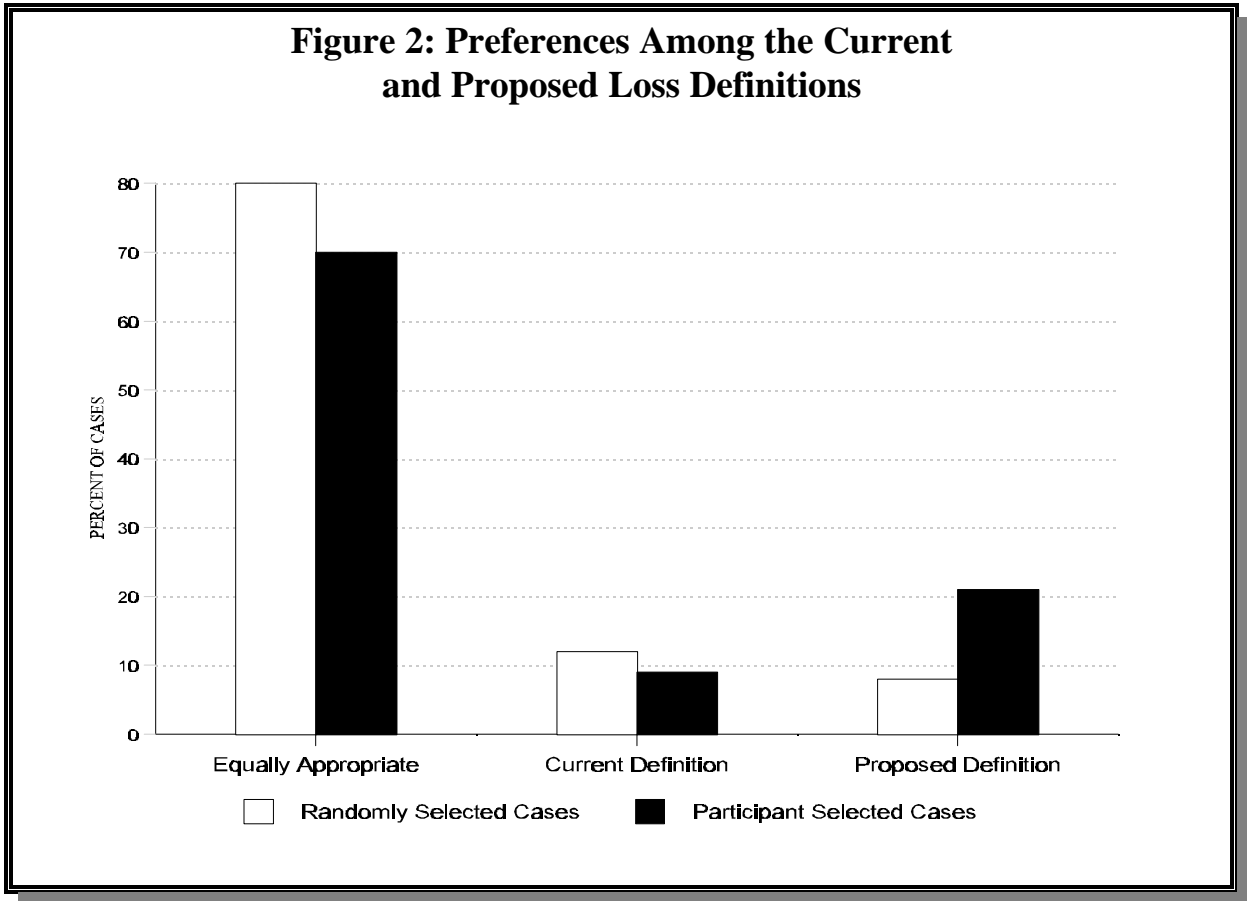
Reasons given by probation officers for preferring the proposed definition included:

- # It is “better organized, more specific.”
- # The “appropriate deference” language broadens courts’ discretion, “reducing necessity of loss determinations.”
- # The concept of “consequential harm” is good, although it “will substantially increase work on each case”

The judge who preferred the current definition stated that the two definitions generally reach the same results, but that the current definition is clearer. The probation officer who preferred the current definition also thought that it resulted in few changes, but that the calculation of gain would require extra work and that the needed information may often not be available.

A more complicated picture emerges from the analysis of the Individual Case Questionnaires. Judges were asked which definition produced the more appropriate result in each particular case. Figure 1 on the following page shows the portion of all random and selected cases in which judges viewed the current or the proposed definition as the most appropriate, or found them to be equally appropriate. In the vast majority of cases, both definitions were viewed as equally appropriate — an unsurprising finding given that both definitions usually lead to the same result. Opinions are more evenly split, however, in the cases in which judges indicated a preference between the two. Among the randomly selected cases, the current definition was preferred in 14 cases and the proposed definition in 10. Among the selected cases (which may have been chosen because the current definition did not work well) the current definition was preferred in nine cases, while the proposed definition was preferred in 21.

Finally, in those cases in which the proposed definition changes the loss amount, judges' preferences are of particular interest. Of the 51 such cases (including both random and selected) on which full data are available, the current definition was favored in six percent and the proposal was favored in 43 percent. In the remaining 45 percent both amounts were viewed as equally appropriate, either because the difference was minimal and did not affect the offense level under the current loss table, or because both results seemed satisfactory.



II. ISSUES RAISED BY THE PRINCIPAL FEATURES OF THE PROPOSED DEFINITION

Throughout the course of developing the proposed loss definition, the Commission identified problem areas by brainstorming over hypothetical loss cases, analyzing the relevant case law, holding hearings, and soliciting informal input from judges, probation officers, and practitioners. The field test provided additional valuable guidance on how to address these issues. The remainder of this report will therefore examine the specific problem areas, incorporating the lessons learned from the field test into a broader discussion of each issue. Particularly helpful to the analysis will be the results of the Hypothetical Loss Scenario. In addition, the discussion of each issue will incorporate comments made by participants who attended the Debriefing Session, including input from the small group discussions that each focused on a discrete set of assigned issues related to the proposed definition.

A. Actual loss

1. Background

At the core of the current definition of loss is “the value of the money or property taken, damaged, or destroyed.”⁵ The proposed definition of actual loss, however, replaces this standard with the more expansive concept of “reasonably foreseeable pecuniary harm.” While the reasonable foreseeability concept was designed to articulate an explicit causation standard that could handle the diversity of cases sentenced under the theft and fraud guidelines, it does give rise to several concerns.

Perhaps the most important aspect of the reasonable foreseeability standard is that it allows for inclusion of some harms that are excluded from loss under the current rule. For example, the current definition explicitly directs courts to include “consequential damages” in loss only in three specific categories of cases (procurement fraud, product substitution, and certain computer crimes), but is silent regarding their inclusion in other cases.⁶ Several courts have read this silence as creating an implication that such consequential harms should not be included in

⁵See U.S.S.G. §2B1.1, comment. (n.2, para. 1).

⁶See *id.* §2F1.1, comment. (n. 7(c)); §2B1.1, comment. (n.2, para. 5).

cases that do not fall into one of these three categories.⁷ The proposed definition, however, would include all harms, as long as they were reasonably foreseeable to the defendant.

The practical application of the reasonable foreseeability rule also merits attention. Questions will arise concerning what losses were reasonably foreseeable, to whom losses were foreseeable, and at what point in time a loss must be foreseeable to be included. For example, are only losses that are foreseeable at the time of the criminal conduct included, or will losses that become foreseeable to the defendant prior to detection of the offense be included as well?

The issue of costs related to the investigation and prosecution of the offense raises an especially common question. Background commentary in the proposal states that “[t]he Commission does not intend that the cost to the government of prosecution and criminal investigation of an offense . . . will be included in the determination of loss, even if such costs are reasonably foreseeable.” But the definition does not address victims’ expenses, and several respondents recommended that further guidance on this type of loss should be added to the definition.

Apart from a reference to “direct and consequential pecuniary harm that is a foreseeable result of the offense” (found in the Background of the proposed definition), the proposal also largely avoids concepts in current case law concerning “intervening acts,” “multiple” or “but-for” causes, and other terms defining the causal nexus required to attribute a loss to a defendant. As a result, interpretation will be needed in some cases.⁸

⁷*See, e.g., United States v. Marlatt*, 24 F.3d 1005 (7th Cir. 1994) (including in loss only the cost of clearing titles to property which the defendant had represented as lien-free and excluding as consequential damages the cost to title company of purchasing properties from buyers); *United States v. Newman*, 6 F.3d 623 (9th Cir. 1993) (including only the cost of vegetation destroyed in arson case and excluding as consequential damages costs of fighting fire); *United States v. Wilson*, 993 F.2d 214 (11th Cir. 1993) (noting that phrase “property taken, damaged or destroyed” does not allow for inclusion of incidental or consequential injury).

⁸*E.g., United States v. Miller*, 962 F.2d 739 (7th Cir. 1992) (counting as loss in fraudulent loan procurement case moneys lost as a result of victim’s conduct but departing downward to reflect loss not attributable to defendant); *Marlatt*, 24 F.3d 1005 (excluding as consequential damages the cost to title company of purchasing properties from buyers); *see also United States v. Berkowitz*, 927 F.2d 1376 (7th Cir. 1991) (including loss due to victim’s failure to mitigate damages); *United States v. Needle*, 72 F.3d 1104 (3d Cir. 1996) (including in loss full amount of damage caused by hurricane where defendant fraudulently obtained business license for insurance company). *Contra United States v. Dadonna*, 34 F.3d 163 (3d Cir. 1994) (excluding from loss cost of completing construction project where defendant who fraudulently disclaimed performance and payment bonds was not at fault).

2. Results of the Hypothetical Loss Scenario

The Hypothetical Loss Scenario completed by participants illustrates the difficult judgments required by the foreseeability standard. The victims of the fraudulent auto insurance scam incurred a range of expenses in addition to the \$200,000 in premiums they paid: (1) \$5,000 in fines and court costs assessed against some victims for not having valid insurance, (2) \$20,000 paid by one victim to settle a lawsuit growing out of an auto accident he had while uninsured, (3) \$6,000 in wages lost by two victims who were fired for having their drivers license revoked due to invalid insurance, and (4) \$15,000 in expenses the victims incurred from their cooperation in the investigation and prosecution of the case.

Ten of the nineteen judges completing this exercise included all the listed expenses in actual loss.

- # All 19 judges included the fines.
- # Four judges included everything except the victims' expenses associated with the investigation.
- # Three judges excluded the victims' investigation expenses and the lawsuit settlement.
- # One judge included the fines and the victims' investigation expenses.

Most judges (15) also included in actual loss the \$60,000 in claims that went unpaid by the defendants' bogus insurance company during the course of its operation. Four, however, did not include this amount. Clearly, the calculation of actual loss under the new definition leaves some room for disagreement, at least in this hypothetical situation.

3. Input from the Debriefing Session

Most participants at the Debriefing Session were in favor of using "reasonable foreseeability" as the core standard for calculating actual loss. The general consensus was that the standard was both appropriately discretionary and familiar from its use in the relevant conduct rule and other legal contexts. Some members of the small group that focused on actual loss suggested the addition of an explicit "but for" element to the definition.

Almost everyone at the Debriefing Session agreed that the proposed definition of actual loss could benefit from some examples of its practical application. The small group that focused on estimation of loss, however, pointed out that a tension could exist between precise examples and the general instruction that loss need not be determined with precision. Nevertheless, the group ultimately decided that the benefit of examples would outweigh their potential harm, as long as the general instruction is highlighted and perhaps moved to a more prominent position in the beginning of the definition.

The small group that focused on actual loss also generally agreed that the concept of reasonable foreseeability needs some sort of limitation to ensure that harms that are too remote from the defendant's conduct will not be included in actual loss. Although there was no consensus on exactly how to impose such a limitation, suggestions were numerous:

- # Provide a list of harms that might fairly be characterized as reasonably foreseeable but which, as a matter of principle or practicality, should nevertheless not be included in actual loss. Such harms might include the government's costs of investigation and prosecution, incidental victim expenses that result from cooperating with the prosecution, etc. (A majority of the small group favored this suggestion.)
- # Give examples of what reasonable foreseeability does and does not encompass. (This was also very popular among the small group members and the participants in the plenary session.)
- # Include restrictive terms in the core definition of actual loss (such as the term "likely" in the proposed definition of "reasonably foreseeable pecuniary harm"), so that judges have a hint as to whether they should interpret the concept broadly or narrowly.
- # Explicitly identify certain kinds of harm as "indirect" or "consequential" and then exclude them from actual loss, perhaps listing them as a basis for upward departure. (Note that many participants in the small group and in the larger plenary session strongly objected to using the term "consequential" anywhere in the definition, although some nonetheless expressed a desire to somehow retain the current rule regarding consequential damages in procurement fraud, product substitution, and computer crime cases.)
- # Use a combination of the above methods.

The participants in the small group came to agreement on two other items. First, any future harms that the prosecution can prove will occur should count as actual loss. Second, the Commission should make the reasonable foreseeability standard more explicitly objective. Rather than using "the defendant knew or . . . should have known," the definition should use "a reasonable person in the defendant's position would have known." Several participants also felt that this part of the definition would also benefit from a provision that ensures that any special knowledge on the defendant's part will be factored into the determination of what was reasonably foreseeable.

The group also discussed, but did not reach consensus on, whether: (1) the definition needs to address the treatment of intervening causes; and (2) the definition should take into account the same considerations as the mandatory restitution provisions. On the latter issue,

some participants felt that because the probation officer will have to look at victims' losses when setting restitution, it might be advantageous to use the same or similar standards in the actual loss determination as are used in the restitution determination. On the other hand, others pointed out that restitution and sentencing focus on different policy goals, and so different standards may be appropriate. Furthermore, restitution generally is based on the offense of conviction, as opposed to the broader "relevant conduct" reach of sentencing.

B. Intended loss

1. Background

The current loss definition does not define intended loss; it merely states that in fraud cases "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."⁹ The proposed definition retains this "greater than" rule, expands its application to theft cases as well, and provides a core definition of intended loss: "the pecuniary harm intended to be caused by the conduct for which the defendant is accountable."

The proposed definition also attempts to resolve an intended loss issue that has appeared in the case law. Some courts have held that a defendant can be held accountable for only that intended loss that might realistically have occurred.¹⁰ The proposed definition does away with this "economic reality" limitation by including all intended harm "even if that harm would have been unlikely or impossible to accomplish."

Possible ambiguities in the proposal's treatment of intended loss emerge from the interaction between its definition of intended loss and the section on credits against loss. The

⁹See U.S.S.G. §2F1.1, comment. (n.7). This "greater than" rule has led to some confusion in the courts. See *United States v. Lauer*, 148 F.3d 766 (7th Cir. 1998) (determining loss in fraudulent investment scheme by adding amount of actual loss to the amount of intended but unrealized loss).

¹⁰Compare *United States v. Galbraith*, 20 F.3d 1054 (10th Cir. 1994) (holding in government sting case that loss was zero because defendant could not have occasioned any loss even if scheme had been completed), and *United States v. Watkins*, 994 F.2d 1192 (6th Cir. 1993) (remanding case to determine intended loss based *inter alia* on the realistic losses the defendant could have caused), with *United States v. Studevart*, 116 F.3d 1559 (D.C. Cir. 1997) (holding that in government sting case definition only requires calculation of "intended loss" and does not require finding that the intentions were realistic), and *United States v. Wai-Keung*, 115 F.3d 874 (11th Cir. 1997) (holding in case involving fraudulent credit card scheme that there was no requirement that intended loss be realistically possible or that defendant was capable of inflicting loss he intends).

definition instructs the court to reduce the loss figure by the value of any economic benefit the defendants transfer to their victims before the offense is detected, but it does not specify whether this reduction applies against actual loss, intended loss, or both. In some cases, this might arise as a timing issue: if the defendant intends a certain loss at one point, but later manifests an intent to cause a lesser loss (e.g., by reimbursing the victim), which figure is used for intended loss?

2. Results of the Hypothetical Loss Scenario

In the Hypothetical Loss Scenario, the co-conspirators successfully completed sales of \$600,000 of worthless insurance and took orders for \$30,000 more. All nineteen judges that completed the Hypothetical Loss Scenario counted the \$600,000 as intended loss, and sixteen judges included the \$30,000 as well. The respondents were evenly split, however, over whether \$60,000 in unpaid victim claims against the bogus insurance company — an amount that almost all judges included in actual loss — should also be included in intended loss.

Moreover, about a third of the judges counted, as intended loss, certain arguably unplanned consequences of the defendants' crime, such as expenses associated with the settlement of a lawsuit and the loss of some victims' driver's licenses. Three judges also included the cost to the victims of assisting in the investigation and prosecution of the fraud. It appears that the distinction between losses that the defendant *intends* and those that actually arise or that the defendant might foresee is not entirely clear in the proposed definition.

The respondents to the Hypothetical Loss Scenario were divided on the credits question: half the judges reduced the intended loss figure by \$40,000 in refunds that the defendants paid to their victims, while half did not. The "economic reality" issue met with slightly more unanimity: only six judges reduced the intended loss figure by 10% based on expert testimony that insurance companies can expect to collect only 90% of premiums on all their contracts.

In short, the intended loss concept proved somewhat troublesome to the participants in the field test. Judges differed more in their approaches toward calculating intended loss than they did toward any other aspect of the proposed definition. In combination with the findings on clarity and workability from Part I, these findings suggest that intended loss is the factor in the proposed definition most in need of refinement.

3. Input from the Debriefing Session

The participants at the Debriefing Session spent considerable time discussing the meaning of the "intent" aspect of intended loss. Should intended loss cover only those harms that it was the defendant's conscious purpose to bring about, as the common legal definition of "intent" might suggest? Or should the Commission broaden the concept to include harms that the defendant *knew* would result, or perhaps even *had reason to know* would result, regardless of

whether they were intended? No consensus emerged, but everyone thought that some clarification was in order.

The small group that focused on intended loss considered defining intended loss as pecuniary harm that was “knowingly and purposely intended to be caused.” Ultimately, however, the group decided to recommend a definition that defined intended loss as “the reasonably foreseeable pecuniary harm intended to be caused.” When this idea was presented in plenary session, it was not well received by all; participants expressed confusion about the interaction between the objective reasonable foreseeability standard and the subjective intent standard.

In discussing the pros and cons of the small group’s recommendation, many participants, including most of the small group, ultimately came out in favor of doing away with the current rule that defines loss as the greater of actual loss and intended loss. They would instead define loss as actual loss plus any unrealized intended loss, *i.e.*, actual loss plus any intended loss that is not already included as actual loss.

Some members of the small group, and some participants in the plenary session, expressed concern about the “economic reality” issue. They questioned whether it was possible for a defendant to intend the impossible. Another issue that was the focus of some discussion was the reference to the guidelines’ attempt provision, §2X1.1; participants were not sure how §2X1.1 was supposed to interact with the loss definition. Finally, several participants wondered whether the loss definition’s credits rule should apply to intended loss. As mentioned above, some characterized this as a timing issue: if a defendant changes his or her intent during the course of the crime — *e.g.*, by deciding to make payments on a fraudulently procured loan — how would the change affect the intended loss figure?

C. Credits

1. Background

Under the current definition, credits against the loss amount are available in three types of fraud cases: product substitution, loan application, and contract procurement.¹¹ The proposed definition broadens this rule by providing for a loss reduction in all types of cases based on “the value of [any] economic benefit the defendant or other persons acting jointly with the defendant transferred to the victim before the defendant knew or should have known that the offense had been detected.” The proposal also provides a revised rule providing for valuation of collateral and an exception to the credits rule for benefits of little value to the victim.¹²

¹¹See U.S.S.G. §2F1.1, comment. (n.7(a)-(b)).

¹²Credits in the context of Ponzi and other fraudulent investment schemes are handled under a special rule, discussed *infra* part II.G.

The proposal's changes to the credits rule reflect concerns that have arisen from the case law — many of which arose in the field test as well. Perhaps most important is the question of whether credits apply against actual loss only, or against intended loss and gain as well.¹³ Other issues include whether courts should give credit for services performed fraudulently, but to the satisfaction of victims, by unlicensed professionals — and if so, how much credit is due? Is credit ever given for payments by third parties (*e.g.*, insurance companies) or for other recovery of losses, even though such payments or recovery are not the result of actions of the defendant or those acting with him?¹⁴

Several respondents questioned the appropriateness of giving credit to the defendant for actions that, although conveying some value to the victim, were nonetheless instrumental in perpetrating the crime. Another issue, which arose in the following case, involved whether credit should be given for services delivered to “victims” when the services, though of some value, are not legitimate, and the loss is borne by a third party.

Case #323269

For twelve years, defendant helped manage a chain of weight-loss clinics. Patients were solicited through print and broadcast advertisements promising “free medically supervised weight-loss treatment.” The clinics actually billed patients’ insurance programs for treatment of non-existent diseases, because treatment for obesity is not covered by most government or private insurance. The clinic waived the amount of any deductible or co-pay. The clinic collected medical histories from the patients and performed lab tests, and then made fraudulent diagnoses based on past medical problems or “out-of-range” lab results. The patients were not informed of these other diagnoses.

¹³See *supra* part II.B and *infra* part II.D.

¹⁴ See, *e.g.*, *United States v. Jackson*, 95 F.3d 500 (7th Cir. 1996) (crediting against loss value of prizes received by victims in telemarketing scheme who sent in money and received prizes worth substantially less than money paid); *United States v. Maurello*, 76 F.3d 1304 (3d Cir. 1996) (crediting value of legal services satisfactorily rendered by disbarred attorney); *United States v. Licciardi*, 30 F.3d 1127 (9th Cir. 1994) (crediting value of grapes actually delivered where defendant misrepresented the variety and origin of grapes sold to obtain higher price); *United States v. Allison*, 86 F.3d 940 (9th Cir. 1996) (holding in credit card fraud case that defendant should be credited with payments made to bank on credit card balances prior to discovery of offense). *But see United States v. Pappert*, 104 F.3d 1559, 1567 (10th Cir. 1992) (refusing to credit defendant for value of machines retained by victims in fraudulent leasing scheme where used machines were sometimes represented to be new, some machines were pledged as collateral on more than one lease and cost to repossess at least one machine was more than its value); *United States v. Bald*, 132 F.3d 1414 (11th Cir. 1998) (refusing to credit defendant who was convicted of credit card fraud for the value of returned merchandise).

The patients sought and received legitimate treatment, but only for obesity. A review of the clinics' bank records revealed that at least \$7,500,000 was billed to insurance companies during the time of the offense. The judge in the original case found the loss to be \$7,500,000.

The proposed rule states that credit should not be given “in cases in which the economic benefit . . . has little or no value to the victim because it is substantially different from what the victim intended to receive.” Another case from the field test raises the question of whether this provision is appropriate and sufficiently clear when the victim does intend to receive the benefit involved, but it is a relatively small part of the total benefit expected.

Case #216873

Defendants operated a fraudulent telemarketing scheme in which victims were told they had won a major prize, such as a new car or Hawaiian vacation. For a one-time fee, payable by electronic transfer from their bank account, they were guaranteed one of the major prizes, a bonus watch, and a three-year membership in a credit card protection plan. The offer was accepted by 18,527 persons, who provided their bank account and credit card numbers. The defendants received \$1,158,228 from successful debits. The operation spent a total of \$34,523 on credit card protection service for some of the victims, obtained through a legitimate business, Safe Card, Inc., for a \$10 fee per person. Safe Card recorded the victim's credit card numbers and notified the appropriate companies if the cards were lost or stolen. An additional \$7,750 was spent on “bonus” watches.

2. Results of the Hypothetical Loss Scenario

The respondents disagreed over whether \$40,000 that the insurance fraud perpetrators refunded to victims who requested cancellation of their policies should be credited against actual loss, *i.e.*, subtracted from the \$200,000 in premiums collected. Twelve of the nineteen judges did reduce the premiums by that amount; those who did not may have refrained because the facts suggested that the defendants returned these premiums “to prevent unhappy policyholders from learning the fraudulent nature of the scheme.” As mentioned above, the respondents were also divided when it came to credits against intended loss: half the judges reduced the intended loss figure by \$40,000 in refunds that the defendants paid to their victims, while half did not.

3. Input from the Debriefing Session

The discussion of credits at the Debriefing Session focused on the distinction between, on the one hand, payments that represent bona fide efforts to reimburse a victim and, on the other, payments that represent attempts to commit further crimes. Most participants felt that no credit should be given for the latter: if the payments were merely intended to recruit more victims and thus perpetuate the fraud, as in a Ponzi scheme, then no credit is warranted. Payments made in good faith, with no criminal purpose in mind, were seen as better candidates for crediting, as were situations in which the defendant gave the victim something of real value, although it might not have been what the victim had been promised.

Several participants felt strongly that credits should be available only in those types of cases where the current commentary provides a crediting rule, *i.e.*, product substitution, loan application, and contract procurement cases. Others pointed out, however, that even under the current rules courts have frequently given credits in other categories of cases as well. Retaining the current rule would therefore leave current case law practice unchanged.

The small group that focused on credits came to a consensus on two issues. First, the group liked the proposed definition's exclusion of credits for items that are of "little or no value to the victim." They suggested that an example of a "gimmie gift," perhaps from a telemarketing scheme, be added to this provision. Second, the group agreed that no credit should be given for services provided by those who falsely claim to be licensed professionals. These suggestions were very well received in the plenary session as well.

D. Gain

1. Background

The current loss definition in the fraud guideline states that "[t]he offender's gain from committing the fraud is an alternative estimate that ordinarily will underestimate the loss." The proposed definition, in contrast, calls for the use of gain instead of loss if: (1) gain is greater than actual and intended loss; and (2) gain more accurately reflects the seriousness of the crime. Aside from this general principle, the proposal offers no guidance on how gain should be calculated.

The most significant issue that arose regarding gain is whether the term refers to gross revenues or net profit. A 1991 guideline amendment changed a reference to "gross gain" in the definition to just "gain."¹⁵ This might be read to imply that the Commission views gain as a net concept — or that the term "gain" by itself means "gross gain," rendering the modifier "gross" redundant. The definition of "pecuniary gain" in the organizational guidelines uses a net "before-

¹⁵U.S.S.G. App. C, amend. 393.

tax profit” method;¹⁶ judges might presume that the Commission intends the two to be consistent. Finally, the dictionary definition of gain gives “profit” as a synonym, consistent with a net approach.¹⁷

Courts have struggled with whether the current rule on gain calls for a net or gross calculation.¹⁸ This may reflect the concerns discussed above in the crediting section: judges may be reluctant to reduce the loss amount to reflect payments to victims intended to perpetuate the fraudulent scheme. The field test also yielded similar examples of difficult issues in the calculation of gain.

Case # 294676

Defendant learned that land adjacent to his ranch had enough timber to sustain a profitable cutting operation. He contacted the state agency that owned the land and was told that multiple bids on the property would be needed prior to sale. Defendant suggested the agency contact his real estate agent as someone familiar with realty transactions in the area. He then directed the agent to send him copies of whatever information the agent provided the state. When the agent was contacted, he sent the agency a letter estimating the property’s value at \$378 to \$600 per acre — even though Defendant had purchased an adjoining plot for over \$2,000 per acre — and sent the Defendant a copy of the letter. Defendant recruited two of his employees to submit bids on the land of \$515 and \$535 per acre, and submitted his own bid of \$605 per acre, for a total bid of \$48,000.

Defendant’s bid won, and he bought the property. Defendant hired a logger to harvest the timber. The logger did so, selling the timber for \$185,417.63. After paying the logger, Defendant netted a profit of \$111,171.25

¹⁶*Id.* §8A1.2, comment. (n.3(h)).

¹⁷WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY 502 (1991).

¹⁸*Compare United States v. Parsons*, 141 F.3d 386 (1st Cir. 1998) (refusing to reduce defendant’s gross gain in bank fraud case by amount by civil settlement negotiated with FDIC), and *United States v. Coyle*, 63 F.3d 1239 (3d Cir. 1995) (calculating loss based on gross gain where administrator of health benefit plans fraudulently retained excess funds rather than returning them to the ERISA funds and refusing to reduce gain by those excess funds that were not contractually required to be returned), with *United States v. Whatley*, 133 F.3d 601 (8th Cir. 1998) (calculating loss in telemarketing case by subtracting from gross revenues money lost to refunds, checks on which payment stopped, costs of prizes, and “gimmie-gifts” but not overhead costs). *Cf. United States v. Badaracco*, 954 F.2d 928 (3d Cir. 1992) (holding that bank officer’s use of position for personal benefit constituted breach of fiduciary duty, was comparable to embezzlement, and justified using gross gain instead of loss.)

from the timber sale. Under the current loss definition, the court found a loss of \$111,171.25.

2. Results from the Hypothetical Loss Scenario

Only a slight majority of judges in the field test offset the defendants' gross income in the hypothetical scenario by the premiums their company refunded due to cancellations of contracts. Moreover, less than half reduced the gain by the advertising costs the defendants incurred to commit their crime. Despite the arguable implications that gain is a net concept, the proposal does not appear to be clear on this issue.

3. Input from the Debriefing Session

As one might expect, the discussion at the Debriefing Session focused on whether gain is a gross or net concept. Several participants felt that the plain meaning of the term contemplates a net calculation; gain means profit. Others, however, objected to deducting from gain any payments related to the expansion of the fraudulent scheme, citing the same concerns discussed in the credits section above. The small group that focused on gain recommended that, whatever the decision, the rule on credits should be the same for both loss and gain.

Even among those who favored some net calculation, there was uncertainty as to what amounts should be subtracted from gain. Perhaps bona fide payments to victims should be deducted, but what about the routine operational expenses necessary to keep the scheme going? In the end, the only clear consensus on this issue was that the Commission needs to give more guidance on the application of the concept of gain.

E. Interest

1. Background

The current loss definition states that loss does not include interest that the victim could have earned had the offense not occurred.¹⁹ Nevertheless, circuit courts have reached different conclusions about whether interest should be included in loss determinations. Some circuits have included interest if the victim had a reasonable expectation of receiving it, or simply an expectation based on the representations of the offender.²⁰ Others have seemingly included it as a matter of course.²¹ Some commentators have proposed that the guidelines should provide a standard rate of return for calculation of interest in bargained-for transactions.²²

The proposed definition includes two options for handling interest. Option 1 would exclude all opportunity costs and interest, but would make them a basis for upward departure if their exclusion results in a loss figure that understates the seriousness of the crime or culpability of the defendant. Option 2 would include accrued and unpaid interest if it was “bargained for as part of a lending transaction.”

Participants were asked to apply Option 2 to the cases they examined, but it is difficult to determine its effects on loss amounts from a field test of closed cases. In several cases judges indicated that the information needed was not available in the presentence report. This does not

¹⁹U.S.S.G. §§2B1.1, comment (n.2), 2F1.1, comment (n.7).

²⁰ See *United States v. Porter*, 145 F.3d 897 (7th Cir. 1997) (including interest in loss where defendant had represented to investors a specific annual rate of return in fraudulent investment scheme); *United States v. Lowder*, 5 F.3d 467 (10th Cir. 1993) (same); *United States v. Allender*, 62 F.3d 909 (7th Cir. 1995) (including interest specified in written loan agreement in a fraudulent loan procurement case).

²¹ See *United States v. Nolan*, 136 F.3d 264 (2d Cir. 1998) (including in loss unpaid interest and penalties where defendant embezzled from pension plan assets, ran fraudulent investment scheme, and defaulted on a fraudulently obtained promissory note); *United States v. Goodchild*, 25 F.3d 55 (1st Cir. 1994) (including finance charges and late fees resulting from unauthorized credit card use); *United States v. Barker*, No. 95-3262, 1996 WL 294141 (10th Cir. June 4, 1996) (unpublished) (including interest on customers’ accounts where bank trust officer’s fraudulently use of trust funds caused bank to have to pay customers interest). *Contra United States v. Guthrie*, 144 F.3d 1006 (6th Cir. 1998) (excluding interest where defendant was convicted of concealing assets in a bankruptcy proceeding); *United States v. Misicka*, No. No. 95 CR 7, 1995 WL 622416 (N.D. Ill. Oct. 20, 1995) (unpublished) (excluding interest that government would have received on funds disbursed to defendant who submitted fraudulent reimbursement vouchers).

²²Frank O. Bowman, III, COPING WITH “LOSS”: A RE-EXAMINATION OF SENTENCING FEDERAL ECONOMIC CRIMES UNDER THE GUIDELINES, 51 Vand. L. Rev. 461, 540-41, 576 (1998).

mean, however, that obtaining such information is impossible. In only five cases did judges indicate it would be impracticable to obtain the needed information to apply Option 2.

Participants were also asked which of the two options was most appropriate in each case. In the vast majority of cases judges indicated that neither option was applicable, but among those in which interest came into play, there was an even split of opinion. In the 121 random cases, Option 1 was preferred in two cases and Option 2 was preferred in three. Among the 107 selected cases, Option 1 was preferred in five cases and Option 2 in four.

2. Results of Hypothetical Loss Scenario

The Hypothetical Loss Scenario was not designed to test the proposal's rule on interest, and the issue did not arise in any of the respondents' calculations or comments.

3. Input from the Debriefing Session

At the Debriefing Session, interest was the issue on which there was apparent unanimity: participants overwhelmingly seemed to feel that Option 1 should be adopted. In reaching this conclusion, participants cited (1) the difficulty in obtaining the relevant information and calculating the proper figure, (2) the unfairness of including it only in those cases in which it is available, (3) the ambiguity inherent in the terms "bargained for" and "lending transaction," and (4) the negligible effect that interest will have on most loss calculations. For those cases in which interest or other opportunity costs might make a difference, participants generally favored the upward departure in Option 1, but several preferred placing it with the other departures in subdivision (G) of the definition.

F. Departures

1. Background

The current guideline lists a number of encouraged upward departures for those cases in which the loss figure "does not fully capture the harmfulness and seriousness of the conduct" and also provides for a downward departure if the loss figure "overstate[s] the seriousness of the offense."²³ The proposed definition revises these provisions and adds some additional departure grounds.

²³U.S.S.G. §2F1.1, comment. (n.10).

Nevertheless, in only five percent of the random cases did judges indicate that they would have departed for any reason related to the loss determination. The departures and reasons given were:

- # Upward because of non-monetary harms.²⁴
- # Upward because of the substantial risk of additional monetary harms.
- # Upward because of defendant's extensive preparation for the fraud and the potential for substantial gain.²⁵
- # Upward because of the large number of victims.²⁶
- # Downward because the loss amount overstated the seriousness of the offense.²⁷

2. Results of Hypothetical Loss Scenario

The Hypothetical Loss Scenario was not designed to test the proposal's departure provisions, and the issue did not arise in any of the respondents' calculations or comments.

3. Input from the Debriefing Session

In the Debriefing Session, the small group that focused on the departure provisions in the proposed loss definition expressed some concern. First, they suggested that having too many

²⁴See *United States v. Forsythe*, No. 97-6250, 1998 WL 539462 (10th Cir. Aug. 24, 1998) (unpublished) (permitting upward departure in telemarketing fraud scheme based on defendant's encouragement of his children to engage in fraud); *United States v. Dobish*, 102 F.3d 760 (6th Cir. 1996) (permitting upward departure for non-monetary and serious psychology injury to victims, jeopardizing victims' solvency, and the repetitive and prolonged nature of crime); *United States v. Wells*, 101 F.3d 370 (5th Cir. 1996) (permitting upward departure in credit card/identity fraud case for damage to victim's credit ratings, embarrassment, and psychological effects on victim).

²⁵See *United States v. Bramble*, No. 97-4452, 1998 WL 455102 (4th Cir. July 30, 1998) (unpublished) (permitting upward departure for intricate and extensive planning for bank embezzler).

²⁶ See *United States v. Benskin*, 926 F.2d 562 (6th Cir. 1991) (permitting upward departure where defendant solicited \$3.8 million from over 600 investors in six-year fraudulent investment scheme).

²⁷ See *United States v. Gregorio*, 956 F.2d 341 (1st Cir. 1992) (permitting downward departure in fraudulent loan procurement case for loss caused by factors beyond defendant's control such as impact of regional economy and victim's conduct).

departure grounds can make the probation officer's job more difficult. Second, several of the listed departure grounds overlap with already existing departure grounds in Chapter Five of the guidelines, creating an unnecessary and potentially confusing redundancy. Finally, the downward departure in subdivision (H)(i) of the proposed definition, regarding mitigating, non-monetary objectives, was seen as perhaps too susceptible to abuse.

The other departure issue that generated some discussion was the downward departure ground in subdivision (H)(ii) for complete restitution. Many participants saw this as repetitive of the proposed credits rules. On the other hand, those who favored a more restrictive crediting provision pointed out that the restitution departure could be maintained as a way of mitigating the effect of having fewer credits available.

G. Special Rules

1. Background

The current definition has a number special rules for particular types of theft and fraud: Davis-Bacon Act offenses, fraud involving the diversion of government benefits, and stolen credit card cases. The proposed definition preserves these rules in essentially the same form, but places them under one heading. It also adds a special rule for fraudulent investment schemes.

Based on the results of the random sample of cases, the special rules concerning fraudulent investment schemes and counterfeit or stolen credit cards would be invoked in only a small fraction of cases (three percent). The rule on diversion of government benefits would be invoked just slightly more often (six percent). No cases involved the special rule concerning the Davis-Bacon Act. One judge commented that the special rule for diversion of government benefits was not needed.

Although the rule on fraudulent investment schemes might apply in few cases, it is the most controversial of the special rules. The rule states that the loss in Ponzi-like schemes is the sum of the net losses of all individual victims who lost all or part of their money.²⁸ Circuit courts have previously used a variety of valuation procedures in these cases,²⁹ and several field test

²⁸This "loss to losing victims" method is derived from *United States v. Orton*, 73 F.3d 331 (11th Cir. 1996) (crediting in Ponzi scheme only amount repaid to original investors and then only up to the amount of their original investment).

²⁹See *United States v. Holiusa*, 13 F.3d 1043 (7th Cir. 1994) (crediting against loss amount returned to investors prior to detection of scheme); *United States v. Loayza*, 107 F.3d 257 (4th Cir. 1997) (refusing to credit amounts returned to early investors as "interest" payments because payments were for purpose of continuing to defraud and not out of any concern to

participants disagreed that the Commission’s chosen resolution of this issue was appropriate. In addition, some commentators have noted that while returns provided to early investors in fraudulent investment schemes might reduce the *actual* loss to victims, they should not affect the *intended* loss, since the returns were meant to perpetuate an ongoing scheme. It is unclear whether the proposed rule is meant to apply to actual loss only and not intended loss.

2. Results of the Hypothetical Loss Scenario

The Hypothetical Loss Scenario was not designed to test any of the proposal’s special rules, and the issue did not arise in any of the respondents’ calculations or comments.

3. Input from the Debriefing Session

As discussed in the credits section above, most participants felt that no credit should be given for payments that represent attempts to commit further crimes. According to this view, if the “return” on a fraudulent investment were merely intended to recruit more victims and thus perpetuate the fraud, as in a Ponzi scheme, then no credit would be warranted.

Conclusion

The results of the field test and the comprehensive comments received at the Debriefing Session have given the Commission a preview of the real-world effect of the proposed loss definition — and, in doing so, have provided an invaluable framework for future revisions. As the Commission continues to work on the economic crimes package and other important issues, the field test of the loss definition will serve as a model for the informed, practical formulation of criminal justice policy.

restore something to victim); *Orton*, 73 F.3d 331 (adopting “loss to losing victims” method).

Appendix A

PROPOSED LOSS DEFINITION

April 2, 1998 Version

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, should have known would likely follow, in the ordinary course of events, as a result of that conduct.

"Intended loss" means the pecuniary harm intended to be caused by the conduct for which the defendant is accountable under §1B1.3, even if that harm would have been unlikely or impossible to accomplish (e.g., as in a government sting operation).

(B) Determination of Loss. The court need not determine the precise amount of the loss. Rather, it need only make a reasonable estimate of that amount, based on available information and using, as appropriate and practicable under the circumstances to best effectuate the general rule in subdivision (A), 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 property taken or otherwise unlawfully acquired or destroyed.

(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.

(C) Gain. The court shall use gain instead of loss under subsection (b)(1) if both (i) gain is greater than loss (which may be zero); and (ii) gain more accurately reflects the seriousness of the offense.

(D) Credits Against Loss. Except as provided in subdivision (F)(i), loss shall be reduced by the value of the economic benefit the defendant or other persons acting jointly with the defendant transferred to the victim before the defendant knew or should have known that the offense had been detected.

In the case of collateral, the value of the economic benefit is the amount the victim has recovered as of the time of sentencing from disposition of the collateral. If the collateral has not been disposed of by that time, the value is its fair market value as of the time of sentencing.

In any other case, the value of the economic benefit is its fair market value as of the time of transfer to the victim.

However, in cases in which the economic benefit transferred to the victim has little or no value to the victim because it is substantially different from what the victim intended to receive, loss shall not be reduced by the value of that economic benefit.

For purposes of this subdivision: (i) "economic benefit" includes money, property, or services performed; and (ii) "transferred" means pledged or otherwise provided as collateral, returned, or otherwise conveyed.

Option 1:

- (E) Opportunity Costs. Interest (of any kind), anticipated profits, and other opportunity costs shall not be included in determining loss. However, there may be cases in which the amount of interest, anticipated profits, and other opportunity costs is so substantial that not including that amount as part of the loss would substantially understate the seriousness of the offense or the culpability of the defendant. In such cases, an upward departure may be warranted.

Option 2:

- (E) Interest. Interest shall be included in determining loss only if it is bargained for as part of a lending transaction that is involved in the offense. The court shall include any such interest that is accrued and unpaid as of the time the defendant knew or should have known that the offense had been detected.
- (F) Special Rules. The following special rules shall be used to assist in determining actual loss in the cases indicated:
 - (i) Fraudulent Investment Schemes. In a case involving a fraudulent investment scheme, such as a Ponzi scheme, actual loss is the sum of the net actual losses of each victim who lost all or part of that victim's principal investment as a result of the fraudulent investment scheme. Because this subdivision provides, in cases covered hereunder, for determination of the net loss of each victim, subdivision (D), relating generally to credits against loss, shall not apply to such cases.
 - (ii) 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, or number or code shall be not less than \$100.
 - (iii) 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.
 - (iv) 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.

- (G) 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:*
- (i) *A primary objective of the offense was an aggravating, non-monetary objective. For example, a primary objective of the offense was to inflict emotional harm.*
 - (ii) *The offense caused 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.*
 - (iii) *The offense created a risk of substantial loss beyond the loss determined above.*
 - (iv) *The offense (I) endangered national security or military readiness; or (II) caused a loss of confidence in an important institution.*
 - (v) *The offense (I) endangered the solvency or financial security of one or more victims; or (II) impacted numerous victims and the loss determination substantially understates the aggregate harm.*
- (H) Downward Departure Considerations. *There also 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:*
- (i) *The primary objective of the offense was a mitigating, non-monetary objective. For example, the primary objective of the offense was 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 would not be warranted.]*
 - (ii) *The defendant made complete, or substantially complete, restitution prior to the time the defendant knew or should have known that the offense had been detected.*
- (I) Appropriate Deference. *The sentencing judge is in a unique position to assess the evidence and estimate the loss based upon that evidence. Accordingly, the court's loss determination is entitled to appropriate deference. See 18 U.S.C. § 3742(e) and (f).*

3. *In some cases in which the amount of intended loss exceeds the actual loss, whether some of the intended loss would have occurred may be speculative. In such cases, the offense level ordinarily applicable to that amount of intended loss sometimes must be reduced, in accordance with §2X1.1. (Conspiracies, Attempts, Solicitations). Specifically, in a case involving only inchoate offense conduct (i.e., a case in which the defendant was convicted only of an attempt, conspiracy, or solicitation, and in which the offense involved only intended loss), a decrease of three levels sometimes may apply, as provided under §2X1.1.*

Similarly, in the case of a partially completed offense (e.g., an offense involving a completed fraud that is part of a larger, attempted fraud in which both actual loss and additional intended loss result), the offense level is to be determined, and may be decreased in some cases, in accordance with the

provisions of §2X1.1, whether the defendant is convicted of the substantive offense, the inchoate offense (attempt, solicitation, or conspiracy), or both. As explained more fully in Application Note 4 of the Commentary to §2X1.1, in such a case, a three-level decrease in the offense level for the intended loss sometimes may apply, except that the offense level for the intended loss, with or without a three-level decrease, shall not be used if it is less than the offense level for the actual loss.

* * *

Background:

* * *

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. 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.

Both direct and consequential pecuniary harm that is reasonably foreseeable to result from the offense will be taken into account in determining the loss. Accordingly, in any particular case, the determination of loss may include consideration of factors not specifically set forth in this guideline. 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, and any lost revenue due to interruption of service. The Commission does not intend that the cost to the government of prosecution and criminal investigation of an offense covered by this guideline will be included in the determination of loss, even if such costs are reasonably foreseeable.

* * *

Appendix B

HYPOTHETICAL LOSS SCENARIO

Please apply the proposed loss definition to the following case scenario, and then answer the questions following the scenario as completely as possible.

Defendant and a group of co-conspirators set up a fraudulent auto insurance scheme, which they ran for four months before law enforcement authorities shut the scheme down and arrested the defendant and co-conspirators. Defendant eventually entered a guilty plea to an information charging him with conspiring to commit wire fraud (as described below) in violation of 18 U.S.C. §§ 1343 and 371.

The scheme involved the following: The conspirators incorporated a shell automobile insurance company and a shell insurance agency. They printed fake stationery, cards, insurance forms and policies, opened a six-month post office box, and opened checking accounts for the company and agency. They also set up an office where conspirators took automobile insurance orders by phone from “customers” who called in. They then began running television ads offering their automobile insurance. When potential customers called, the conspirators quoted rates and accepted orders for policies. Once an order was taken, a runner would go to the customer’s home to get the customer's signature and initial premium payment. A phony declaration sheet containing the terms of the policy was left with the customer, and a phony policy was later sent to the “policyholders,” along with envelopes for mailing in the subsequent premium payments to the “insurance company” at the post office box they had rented.

The “insurance policies” were completely worthless, because no actual insurance coverage was ever arranged with a legitimate insurance company. During the four-month course of the scheme, 800 people contracted for worthless policies. The total amount of the premiums that would have been paid over the 6-month life of the policies sold was \$600,000. The conspirators had managed to collect \$200,000 in premiums before being shut down by the authorities. The paperwork discovered in the search of the conspirators’ office indicated that telephone orders had been taken for additional policies, for which they had not had time to obtain a signature and collect the initial premium. Those telephone orders would have totaled \$30,000 in additional premiums.

The co-conspirators did not pay \$60,000 in accident claims from policyholders that came in during the course of the scheme. They did, however, refund \$40,000 in premiums for customers who requested cancellation of their policies for various reasons, such as moving out of state or finding a lower premium. They did this in order to prevent unhappy policyholders from learning the fraudulent nature of the scheme. The conspirators paid \$10,000 in costs (including TV ads) and wages to run the operation during the four months. An insurance industry expert testified at sentencing that insurance companies generally do not collect more than 90% of the total premiums contracted for, due to the fact that there are inevitably cancellations, deaths, disappearances, and delinquencies in payments.

