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PREPARED STATEMENT:

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I. INTRODUCTION

I would like to begin by thanking the Commission for once again giving me the opportunity to address you on the important subject of economic crime sentencing. Both Commissioners and Staff deserve the highest praise for the difficult work you have done in bringing reform of so vexed and important an area of sentencing law close to fruition. I am hopeful that you will be able to resolve any remaining difficulties and adopt in this amendment cycle a comprehensive new approach to economic crime sentencing to which you can point with pride as a lasting legacy of your simplification effort.

The remarks that follow presuppose some familiarity with proposals I have previously presented to the Commission.[1] I have tried not to repeat myself here. Rather, what follows is a detailed analysis of the most recent draft of a consolidated theft-fraud guideline prepared by Commission staff and dated 2/20/98. I have also appended a proposed consolidated theft-fraud guideline that builds on the 2/20/98 Staff draft.

A final introductory comment: What follows is a fairly long paper. Its length should not be taken as an implicit judgment that the Commission cannot complete its work on a consolidated

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[1] For a detailed analysis of "loss" and economic crime sentencing, *see* Bowman, *Coping With "Loss": A Re-Examination of Sentencing Federal Economic Crimes Under the Guidelines*, 51 VANDERBILT L. REV. -- (forthcoming, April 1998). For an abridged version of this analysis and the text of a proposed consolidated theft-fraud guideline, *see* Bowman, Written Statement for October 15, 1997, Sentencing Commission Hearing, and Bowman, *Back to Basics: Helping the Commission Solve the "Loss" Mess With Old Familiar Tools*, 10 FED. SENT. R. 115 (Nov-Dec 1997).

economic crime guideline this year. The 2/20/98 draft should not become law in present form. Without several key changes, its adoption might well create more problems than it would solve. However, the 2/20/98 draft has much to commend it. With relatively modest changes, it could be transformed into a coherent, workable approach to measuring "loss."

II. THE BASIC APPROACH

The basic approach of the 2/20/98 Staff draft is sound. First, the theft and fraud guidelines *should* be consolidated, and the draft consolidates them. Second, the current rule that "loss" is the greater of actual or intended loss *should* be retained, and the draft retains it. Third, "loss" *should* be redefined in terms of causation -- cause-in-fact and the foreseeability to defendants of the economic harm they cause -- and the draft's core loss definition is cause-based. The Commission's decision to base its reform effort on these principles is a huge step in the right direction. Nonetheless, some challenging questions of implementation and drafting remain.

The three keys to a successful solution of the "loss" problem are: (1) a doctrinally sound core definition of the term "loss," supplemented by (2) coherent definitions of the concepts that make up the core definition, and (3) instructions to courts on how to deal with the most commonly recurring problem cases, instructions that are themselves both comprehensible to courts and consistent with the core definition. The Commission's 2/20/98 draft satisfies the first condition, a good core definition, reasonably well. Conditions (2) and (3) are not quite so fully realized.

III. The Core Definition of "Loss"

A. Actual Loss

The 2/20/98 draft defines "actual loss" as *"the reasonably foreseeable harm that (i)*

resulted, as of the time of sentencing, from the conduct for which the defendant is accountable under §1B1.3 (Relevant Conduct); and (ii) is reasonably certain to result after that time from such conduct." There are at least three difficulties with this language:

1. <u>"Loss" Is a Measurement of Economic Harm</u>

The 2/20/98 draft language does not limit "loss" to economic or pecuniary harm. Language imposing such a limitation should be added, for a number of reasons:

First, the subject matter of this proposal is economic offenses, that is crimes made punishable because they harm victims by depriving them of property interests. Sentence levels for theft and fraud crimes, federal and state, have traditionally been based in large measure on the sound intuition that stealing more is worse than stealing less, primarily because stealing more causes greater economic harm than stealing less. This traditional ranking method is reflected in the current Guidelines Although the existing theft and fraud guidelines do not expressly limit "loss" to pecuniary harm, even a cursory reading of the application notes relating to "loss" in §2B1.1 and §2F1.1 establishes that both guidelines were written with that unstated understanding.

It would be unwise to adopt a core definition of "loss" that leaves open the possibility of including non-economic harms in the calculus. First, the most common non-economic harms associated with property crimes are already accounted for in other provisions of substantive or sentencing law, or if they are not, should be addressed separately and specifically and not by vague implication in the core "loss" definition:

** For example, most criminal conduct which involves stealing but which also invades other interests (such as bodily integrity or the security of one's home) is punished not as theft or fraud, but under other statutes such as robbery or extortion or burglary. Both the Guidelines and pre-Guidelines law treat such offenses as qualitatively different than theft and fraud, and sentence them accordingly.

** Moreover, the special harm inflicted on particularly vulnerable classes of victims such as the elderly or those targeted by hate crimes is addressed by the "vulnerable victim" enhancement of §3A1.1.

** In addition, if the Commission desires to make special provisions for unusually severe *effects* of theft crimes that are not necessarily a function of dollar amount of the loss, such as bankruptcy, the loss of a home, or the like, it can and should do so through a separate enhancement targeting such circumstances.[2]

** Finally, both the current fraud guideline and the 2/20/98 draft contain departure provisions for "non-monetary" harms.

Second, "loss" is a number which must be calculated in every case. A "loss" definition that invites inclusion of non-economic harms needlessly complicates the calculation and the evidentiary hearings necessary to create a record in support of the calculation. If "loss" is not limited to pecuniary harms, aggressive prosecutors will argue that the court should assign monetary values to, and then include in "loss," harms like victims' embarrassment, emotional distress, psychiatric counselling, marital stress, and the like.

Third, in the 2/20/98 draft, upward departure considerations (F)(i), (F)(ii), and F(iv), as well as downward departure consideration G(i), all contemplate departures for "non-monetary" harms or objectives, thus strongly implying that "loss" is intended to embrace only economic harms. If that is indeed the Commission's intention, why not say so plainly in the core definition and remove all doubt?

2. <u>Is It Prudent to Include in "Loss" Harms "Reasonably Certain" to Occur in the Future?</u>

The 2/20/98 draft definition includes in "loss" harms that have not occurred as of the time of sentencing, but which are "reasonably certain" to occur in the future. This seems a potentially

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[2] I have proposed such an enhancement for "significant financial hardship" in *Coping With "Loss," supra* 54-55 (manuscript).

troublesome innovation.

The desire to include such unconsumated harms in "loss" is understandable.[3] There are occasions when the full scope of the economic damage to a victim will not be conclusively established by the sentencing date. Collateral posted by the defendant in a fraudulent loan transaction may not have been liquidated. Other chains of economic cause and effect started by the defendant's crime may not have run their full course.

Nonetheless, the language proposed here presents numerous difficulties. The first is that by insisting future harms be "reasonably certain" to occur, the draft creates immense confusion about the burden of proof for such harms. *Query*: Under this rule, would the prosecution have to prove present or past harms by a preponderance of evidence,[4] but prove that future harms are "reasonably certain"? Or would the prosecution have to prove by a preponderance of evidence that future harms were "reasonably certain"? In either case, what does "reasonably certain" mean? Does it mean "more probable than not" (in which case the standard is nothing more than another way of saying preponderance)? Or does it mean "by clear and convincing evidence"(in which case the Commission should say so)? If, however, it means neither "by a preponderance of evidence" or "by clear and convincing evidence," the Commission should think carefully about whether it wishes to complicate the lives of both district and appellate court judges by creating a unique and undefined burden of proof solely for one subcategory of "loss."

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[3] Moreover, it is not unconstitutional to punish a defendant based in part on a prediction that a past crime will cause harms that occur or persist after sentencing. For example, we sentence murderers not merely because but for the murder the deceased victim would have been alive at sentencing, but also because the deceased and his survivors were deprived of a life that would probably have extended on long past sentencing. *See Payne v. Tennessee*, 501 U.S. 808 (1990) (upholding admission of victim impact evidence on ground that future effect of killing on survivors is ordinarily foreseeable to defendant).

[4] The burden of proof at sentencing is preponderance of the evidence. [cite]

Unconsumated harms, if they are to be addressed at all, should not be addressed in the core "loss" definition..

3. <u>Time of Measurement of "Loss" Should Not Be Part of the Core Definition</u>

The question of when to measure "loss" is too complicated to be woven into the core definition of "actual loss." It should be treated separately in a subsection devoted to that subject. (See discussion below.)

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In sum, the core definition of "actual loss" should read simply:

"Actual loss" means the reasonably foreseeable harm caused by the conduct for which the defendant is accountable under §1B1.3 (Relevant Conduct).

B. Intended Loss

1. <u>The Definition of Intended Loss</u>

The 2/20/98 draft defines "intended loss" as "*the harm intended to be caused by the conduct for which the defendant is accountable under §1B1.3, even if the harm intended to be caused would have been unlikely or impossible to accomplish (e.g., as in a government sting operation).*" This approach represents a perfectly sound policy choice and is, moreover, in accord with the overwhelming weight of current case law.

Nonetheless, the language of the 2/20/98 draft should be modified somewhat because its blanket cross-reference to §1B1.3 (Relevant Conduct) will create unnecessary complications. Section 1B1.3(a)(1)(A) of the relevant conduct guideline makes a defendant accountable for his own conduct, as well as the conduct of others that he caused, commanded, or induced. By contrast, §1B1.3(a)(1)(B) renders a defendant accountable for harms resulting from the

"reasonably foreseeable" conduct of co-conspirators. By cross-referencing §1B1.3 in its entirety, the 2/20/98 draft seems to define "intended loss" to include harms the defendant *intended* to be caused by co-conspirator conduct which, from the defendant's point of view, was *foreseeable* but not necessarily intended.[5] We should avoid asking courts to unravel the enigma of whether a defendant can intend harms caused by the foreseeable but unintended actions of others. A solution to this difficulty might read roughly as follows:

> *"Intended loss" means (i) the harm the defendant intended to be caused by the conduct for which the defendant is accountable under §1B1.3(a)(1)(A), and (ii) in the case of jointly undertaken criminal activity, the harm the defendant intended to be caused by the acts and omissions of others in furtherance of the jointly undertaken criminal activity. A harm otherwise includable in intended loss shall not be excluded because it would have been unlikely or impossible to accomplish (e.g., as in a government sting operation).*

2. Departure for "inept manner"

The 2/20/98 draft contains a provision for a downward departure where "*[t]he offense was committed in such an inept manner that no reasonable likelihood existed that any harm could have occurred.*" Application Note 2(G)(ii). This provision could only apply to cases in which the "loss" for loss table purposes is intended loss. Note 2(G)(ii) should be deleted or redrafted.

First, Note 2(G)(ii) is theoretically unsound. The substantive criminal law does not exonerate offenders from liability for incompetence. Similarly, nowhere else in the Guidelines is there a provision for reducing a sentence for ineptitude. We do not reduce the punishment of those who conspire to rob banks or sell drugs because they are bunglers. It is difficult to see why

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[5] This is not a problem in the definition of "actual loss" because actual loss is itself defined in terms of reasonable foreseeability.

untalented would-be thieves should get a special break.

Second, Note 2(G)(ii) will generate unnecessary litigation because, as written, it seems somewhat at odds with the basic definition of "intended loss" in the 2/20/98 draft. The apparent intention of the 2/20/98 draft is to ensure that intended loss be used in all cases, particularly government sting cases, in which actual loss was factually improbable or impossible. If Note 2(G)(ii) is adopted, creative defense counsel in every case involving unconsumated economic harm will argue that the failure was due to the client's manifest incompetence. Not even government stings will be entirely exempt from this argument, because defense counsel will contend that the government snare was so obvious that only an inept (and by implication inexperienced and naive) person like the defendant would have fallen for it.

I assume that the true purpose of Note 2(G)(ii) is to leave open a very narrow window for departure in genuine cases of factual impossibility, excluding government undercover operations. A better solution to this problem would be to draw from the well-established substantive criminal law of impossible attempts and permit departure in those rare cases in which no loss could have occurred *even if the facts were as the defendant believed them to be*. This approach would eliminate impossibility arguments by defendants in government sting cases (because the success of any sting depends on the defendant's belief that government informants or undercover agents are something they are not), while retaining some flexibility to accomodate the truly unusual case in which a defendant neither caused nor created a risk of any actual harm whatever.[6]

The following language might meet the purpose:

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[6] *See, Coping With "Loss", supra* at 137-39 (manuscript).

> [A departure may be warranted where:] *The conduct for which the defendant is accountable under §1B1.3 caused no actual loss, and the loss intended by the defendant could not have occurred even if the facts were as the defendant believed them to be. A departure on this basis is not available in cases involving government undercover operations or "stings".*

IV. Defining the Concepts in the Core "Loss" Definition

As noted above, the core "loss" definition in the 2/20/98 draft is a giant leap toward the goal of sensible reform. Nonetheless, this strong beginning could be dramatically improved by giving sentencing courts additional guidance in the form of brief definitions of the critical concepts that make up the core definition. In particular, the Commission should: (i) state in plain language the standard of cause-in-fact it intends courts to apply; (ii) define the term "foreseeable;" and (iii) help courts identify the "victims" whose economic injuries are to count in measuring "loss."

A. A Standard for "Cause-in-Fact"

The core "loss" definition in the 2/20/98 draft embodies the sound judgment that loss should include all harms that: (1) were caused in fact by defendant's conduct, and (2) were reasonably foreseeable to the defendant. However, the 2/20/98 draft does not identify or define a standard for cause-in-fact. In past submissions to the Commission, I have urged the adoption of a cause-in-fact standard (the "substantial factor test") more stringent than "but for" causation.[7] I am increasingly disposed to think that any standard other than "but for" causation introduces more practical complications than the possible gain in analytical precision is worth. The key point, however, is that different standards do exist and the Commission should specify the standard it wants the courts to apply.

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[7] *See* Bowman Prepared Statement, Hearing of U.S. Sentencing Commission, October 15, 1997; and *Coping With "Loss," supra at* 91, 93-95 (manuscript).

The 2/20/98 draft says only that loss is harm "resulting from" defendant's conduct. Sentencing courts may infer from this language that the cause-in-fact standard is "but for"causation, but that is not a necessary implication. Over the centuries, courts have applied various cause-in-fact standards depending on the subject matter and the circumstances. If it is the Commission's intention to make the standard of cause-in-fact "but for" (*i.e.*, to include in "loss" harms reasonable foreseeable to the defendant that would not have occurred "but for" the defendant's conduct), then the guideline should say so plainly and eliminate a source of confusion that has created problems in cases such as *U.S. v. Neadle*.[8]

B. Defining "Foreseeability"

The 2/20/98 draft wisely makes reasonable foreseeability the touchstone of whether an economic harm is to be included in "loss." However, the Commission should go one step further and include carefully crafted language defining the term "foreseeable." Foreseeability is a remarkably elastic term. What the law finds "foreseeable" in a tort case is often very different than what it views as "foreseeable" in a contracts case or a case of criminal negligence. Absolute precision is, of course, impossible, but the commission can and should give sentencing courts some guidance about whether foreseeability is to be construed very broadly or somewhat more conservatively in the "loss" context. There are several reasons for favoring a conservative approach:

First, to a far greater extent than other legal fields (such as torts, which focuses on compensation of the injured and encouraging social mechanisms such as insurance for sharing the cost of injuries), the emphasis in criminal law is on fault. Therefore, sentencing courts should

[8] 72 F.3d 1104 (3d Cir. 1995).

insist that a defendant be punished only for harms that would realistically have been foreseeable to *this* defendant given the facts available to him at the time he acted.

Second, one of the legitimate concerns about a foreseeability-based "loss" definition is that it may tempt some courts and litigants into disputes over tangential issues remote from the essence of the defendant's crime. A limiting definition of forseeability reduces the chances of such distractions.

I would suggest addition of the following definition of "foreseeable":

> *A "reasonably foreseeable harm" is one that ordinarily follows in the usual course of events from the conduct for which the defendant is accountable under §1B1.3 (Relevant Conduct), or that a reasonable person in the position of the defendant would have foreseen as a probable result of such conduct.*[9]

C. Who are the "victims"?

The 2/20/98 draft, like the current guidelines, does not tell the courts who the "victims" are; that is, it does not identify the persons or entities whose economic injuries are to be counted in calculating "loss." This void is the source of many loss calculation quandaries under the current guidelines.[10] It may be that an explicit definition of the vicim class was omitted because it was felt that the question of victim identity is answered implicitly by the core loss definition. In other words, since "loss" is the sum of the reasonably foreseeable harms caused by a defendant's conduct, then it follows without elaboration that victims are simply those who suffered the

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[9] For a full discussion of the derivation of this language, *see, Coping With "Loss," supra* at 98-102 (manuscript).

[10] For a discussion of a number of cases illustrating the "who's the victim?" problem, *see, Coping With "Loss", supra* at 58-67 (manuscript). These cases include *United States v. Harper*, 32 F.3d 1387 (9th Cir. 1994); *United States v. Maurello*, 76 F.3d 1304 (3d Cir. 1996); *United States v. Sapp*, 53 F.3d 1100 (10th Cir. 1995). *Also, compare United States v. Marcus*, 83 F.3d 606, 610 (4th Cir. 1996), *with United States v. Chatterji*, 46 F.3d 1336, 1340 (4th Cir. 1995).

foreseeable harms. That is indeed the correct answer to the question of who is the victim, *so why should the Commission not say so and remove any litigation-generating doubt*?

V. Calculating "Loss"

A. Gain

I have hitherto 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.[11] Although I continue to think this is true in most cases, I have become convinced that 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. Accordingly, Application Note 2(B)(vi) from the 2/20/98 draft, or something very like it, should be adopted.[12]

B. Interest

The provisions of the 2/20/98 draft regarding interest are a signal improvement over the January 1998 proposal which relegated interest to a departure factor. Fair arguments can be made for either including or excluding interest from "loss." But the Commission must decide and

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[11] *See, Coping With "Loss", supra* at 62-65, 102 (manuscript).

[12] I remain doubtful about the notion of using gain as a measure of loss when it is "greater than loss." First, I have yet to see a case in which this was true. In every case brought to my attention in which it has been alleged to be true, the victims have not been properly identified. Second, using gain as loss in a case where gain exceeds loss 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. 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 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, but for the benefit he had obtained. Nonetheless, I would be disposed to leave proposed Application Note 2(B)(vi) as written. If I am correct in thinking that gain never exceeds loss, then this provision will seldom be invoked. In the cases the provision is most likely to be used, particularly cases of regulatory crime, it will provide judges a tool to reach the correct result for the wrong reason.

state its conclusion unambiguously. Without a decision, the interest question will generate endless litigation and unavoidable disparity.

The best solution to the interest question is a simple solution. The consolidated economic crime guideline should either: (1) exclude all interest, including both bargained-for and opportunity cost interest, or (2) include interest in all cases in which the promise of a return on investment was part of the inducement to fraud, but make the interest rate uniform in all cases.

1. *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. But the consistency argument proves too much. If we are going to include in "loss" the time value of the 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.

If interest is to be included in "loss," the Commission should strongly consider using a standard interest rate for all defendants. This for two reasons: First, "loss" is primarily a measurement of actual harm actually suffered by the victim, not of the magnitude of the false promises of the crooked defendant. If a defendant defrauded Victim A by promising payment of 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. Two defendants who stole the same amount of money should not receive different sentences merely because one falsely promised his victims a 50% return, and the other promised 100%. Third, using different interest rates in every case adds to sentencing complexity. Federal law establishes a rate to be paid to litigants in civil cases in 28 U.S.C. §1961. If interest is to added into "loss," the simplest, most equitable, and most theoretically sound way of doing so is to use a standard statutory rate.

2. *Arguments for exclusion of interest*

Increasingly, I am disposed to think that simplicity should trump consistency, and therefore that interest should simply be excluded from "loss." 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. Indeed, particularly if interest is assessed at a standardized market rate, the interest component of "loss" is really a proxy measurement, not of relative offense seriousness, but of the length of time elapsed between the taking of the money and the date of sentencing. For example, if two defendants each steal $10,000 by the same means on the same date, but one is sentenced six months after the crime, and the other is sentenced eighteen months after the crime, the defendant sentenced later would have more interest added to his "loss" figure and therefore, at least potentially, would receive a longer

sentence.[13] This is an absurd and unjust result.

3. *Recommendations*

If the choice were mine, I would exclude interest and use language signalling to the courts that the Commission means exactly what it says.[14] At present, I am unsure about Option 1 regarding interest in the 2/20/98 draft. Excluding "anticipated profits and and other opportunity costs" has some appeal; however, I am concerned about confusion that may result when defendants seek to characterize reasonably foreseeable harms otherwise includable in "loss" under the core definition as "profits" or "opportunity costs" in order to exclude them.

If the Commission were to decide to include interest, then the inclusion should extend to all cases in which a defendant's promise of a return on investment induces a victim to part with his money in reliance on that promise. Limiting such a provision to cases where the promised return was labelled "interest" is irrational. *Option 2* should be redrafted along the following lines:

> *(D) <u>Interest.</u> Interest shall be included in loss only if the defendant promised to pay interest or otherwise promised a return on investment as part of the inducement upon which a victim relied in deciding to part with his money, property, or other thing of value. The court shall include interest calculated from the time at which the victim was deprived of the money, property, or other thing of value until the [time of sentencing] or [time the crime was detected].*

C. <u>"Credits Against Loss" and Time of Measurement</u>

The provisions of the 2/28/98 draft that need the most significant revision are that section of Application Note 2(A) governing time of measurement, and the "Credits Against Loss" section

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[13] This assumes that accrued interest is to be measured at the date of sentencing, as the 2/20/98 draft proposes. If interest is measured only until the time of detection, then interest becomes a proxy measurement for the length of time the defendant evaded detection, a factor which arguably bears at least some relation to culpability.

[14] For example: *"(D) <u>Interest.</u> Loss does not include either bargained-for interest or opportunity cost interest."*

(Application Note 2(C)). The two questions are inescapably intertwined and will be addressed together here.

1. *The proposed "time of measurement" rules are confusing and unwieldy.*

Leaving to one side for the moment the question of whether the approach to time of measurement taken in the 2/20/98 draft is substantively sound, as a practical matter the proposed rules are almost unusably complex. According to the 2/20/98 draft:

(i) The basic rule (App. Note 2(A)) is that "loss" is measured "*as of the time of sentencing*."

(ii) But that same basic rule also provides for including in loss some harms that *have not even occurred by sentencing*. However, the rule gives no indication how such future harms are to be valued.

(iii) Under Application Note 2(C), the aggregate "economic benefit[s] the defendant transferred to the victim" are *credited* only up to the *time of discovery*.

(iv) However, those same "economic benefits" are *valued* when the transfer from the defendant to the victim occurred, ***unless...***

(v) The "economic benefit" takes the form of "collateral," in which case it is valued *when liquidated* (at liquidation price), ***unless ...***

(vi) The collateral has not been liquidated by the time of sentencing, in which case it is valued at its market price on the *date of sentencing*.

The complexity of the timing scheme is exacerbated by the imprecision in the terminology, particularly in App. Note 2(C):

"Economic benefit": This term is defined as "money, property, services performed, *or other economic benefit*." In short, "economic benefit" means "economic benefit."

"Pledged or otherwise provided collateral": The defining feature of "collateral" is precisely that it *is* pledged, *i.e.*, that the pledgee receives a security interest in the property which

can be speedily liquidated with minimum legal formalities upon the occurrence of a default by the pledgor or of some other specified condition. It is unclear how collateral could be "provided" other than by being "pledged." The language of the 2/20/98 draft obscures the distinction between genuine collateral and other sources of potential repayment that thoughtful courts have struggled to maintain under the present guidelines.[15] Moreover, if "collateral" is not limited to property in which defendant has transferred a security interest to the victim (a reasonably discrete, legally recognizable event), but instead includes other kinds of property and other less formal varieties of "transfers" of contingent interests in property, then in many cases it will be extremely difficult to determine when the "transfer" occurred and thus to determine when the collateral should be valued.

Consider the following examples:

(i) Precious metals / rare coins boiler room: The defendants sell over the telephone to hundreds of victims supposedly "rare" coins or ingots of precious metals at vastly inflated prices. The defendants do send coins to the victims, and the coins have some value. However, the value of the coins is much less than represented *and* the value fluctuates over time. In such a case, the 2/20/98 draft would require the court to determine the date of every "transfer" of coins, and determine the value of the coins for every date on which a transfer occurred. In a routine boiler room case, this would involve hundreds or even thousands of different valuations.

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[15] *See, e.g., United States v. Chorney*, 63 F.2d 78, 82 (1st Cir. 1995)("To give the defendant credit for other, unpledged assets is simply a free ride for the wealthy defendant and wholly at odds with the underlying purpose of the guideline.") *See also, United States v. Rothberg*, 954 F.2d 217, 219 (4th Cir. 1992) (holding in case concerning damages that could be recovered by the victim in a civil proceeding that assets other than collateral which a bank may recover are "akin to restitution and [are] not a proper consideration in determining the loss suffered as a result of the fraud."). *Accord, United States v. Lucas,* 99 F.3d 1290, 1298-99 (6th Cir. 1996); *United States v. Estari*, 46 F.3d 1127 , 1995 WL 44656 (4th Cir. 1995)(unpublished).

(ii) Stock fraud: Defendant makes an initial stock offering in the penny stock market, and makes inflated and untrue claims in the prospectus. Hundreds of victims buy the stock over a six month period, during which time the stock steadily gains in value. At the end of the six month period, the defendant's falsehoods come to light and the value of the stock plunges to zero. In such a case, not only would the 2/20/98 draft's "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.

2. *The proposed "credits against loss" and time of measurement rules are substantively problematic.*

a) Measuring "loss" at time of sentencing: It is unclear why the 2/20/98 draft adopts the general rule that "loss" should be measured at the time of sentencing. The current guidelines do not employ such a rule. Only two circuits (the Third and Seventh) have ever suggested such a rule[16] (and both of those circuits have also written opinions stating that "loss" should be measured at other times[17]). Most importantly, a time of sentencing rule has significant practical and theoretical drawbacks.

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[16] *United States v. Kopp*, 951 F.2d 521, 535-36 (3d Cir. 1991) (Fraudulent loan application case -- "[F]raud 'loss' is, in the first instance, the amount of money the victim has actually lost (*estimated at the time of sentencing*), not the potential loss as measured at the time of the crime. However, the 'loss' should be revised upward to the loss that the defendant intended to inflict, if that amount is higher than actual loss." Emphasis added.); *United States v. Chevalier*, 1 F.3d 581, 585-86 (7th Cir. 1993) (citing *Kopp*).

[17] *United States v. Shaffer*, 35 F.3d 110 (3d Cir. 1994)(time for determining loss is time crime is detected); *United States v. Carey*, 895 F.2d 1336 (7th Cir. 1990) (finding time for determining loss is time crime is detected).

At least seven circuits have written opinions measuring "loss" at the *time of detection*.[18] For most cases, it makes the best sense. 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.[19] 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.

b) Credits Against "Loss":

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[18] *United States v. Fraza,* 106 F.3d 1050 (1st Cir. 1997) (holding loss is amount of fraudulent loan not repaid at time offense was discovered); *United States v. Stanley*, 54 F.3d 103, 106 (2d Cir. 1995) (Bank trust officer buys bonds at high price for trust clients of bank. As bonds begin to devalue, officer misstates their value in bank records and in statements sent to clients. Hence, neither bank nor clients could act to sell and stem losses. Court finds loss is amount of devaluation in period between misstatements to bank and customers and the time at which fraud was discovered.); *United States v. Shaffer*, 35 F.3d 110 (3d Cir. 1994)(time for determining loss is time crime is detected); *United States v. Bolden*, 889 F.2d 1336 (4th Cir. 1989) (same); *United States v. Akin*, 62 F.3d 700, 701 (5th Cir. 1995) (rejecting argument of check kiting defendant that the loss figure should be reduced by restitution payments made between time of discovery of kite and sentencing, and holding loss to be measured at time of discovery of scheme); *United States v. Frydenlund*, 990 F.2d 822 (5th Cir.), *cert. denied* -U.S. - , 114 S.Ct. 337, 126 L.Ed.2d 281 (1993) (rejecting argument that check kiting should be treated like fraudulently obtained loan and instead measuring loss at time of discovery of scheme); *United States v. Flowers*, 55 F.3d 218, 220-22 (6th Cir. 1995) (holding in check kiting scheme that loss is to be amount of outstanding bad checks, less any amount in accounts at time of discovery.); *United States v. Carey*, 895 F.2d 1336 (7th Cir. 1990) (finding time for determining loss is time crime is detected).

[19] *See, e.g., United States v. Wright*, 60 F.3d 240 (6th Cir. 1995).

The fundamental principle embodied in the credits section of the 2/20/98 draft is sound. If "loss" is to have any meaning as a measurement of economic harm to victims, it must be a measurement of *net* economic deprivation. There is a difference between:

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

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

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

The flaw in Application Note 2(C) of the 2/20/98 draft is that it tries to shoehorn too many different situations into the same language. Notably, the 2/20/98 draft lumps together as "economic benefit[s] ... transferred to the victim": pre-detection repayments of stolen or embezzled money, property transferred from the defendant to the victim in the course of committing the crime (*e.g.,* over-valued stock or coins, Ponzi scheme "dividends,"), and collateral pledged as part of a fraudulent loan transaction. In fact, we probably want to treat these items somewhat differently. In particular, we probably want to treat outright property transfers

differently than pledges of collateral. An outright transfer gives the victim complete control over the property; a pledge of collateral is nothing more than a contingent, legally unperfected interest. Brevity is, of course, desirable, but sometimes brevity must be sacrificed for clarity.

3. *A Simpler Solution*

a) Time of measurement: The 2/20/98 draft is unnecessarily complicated because it requires the court to measure and value different components of "loss" on many different days. A good time of measurement rule will have the court measure and value all the components of the "loss" calculation -- both the property of which the victim was deprived and any thing of value provided to the victim by the defendant -- on the same day. Some narrow and carefully crafted exceptions to this principle may be required, but they must remain narrow and infrequent if the rule is to be simple and easy to apply.

The general rule should be that "loss" is measured at the time the crime is detected. The principal difficulty with a pure "time of detection" rule concerns defendants who steal or embezzle and then pay back the money before they are caught, for example, a bank officer who embezzles funds to speculate in the stock market, succeeds in the speculation, and pay back the funds before anyone is the wiser. The Commission could either: (1) Take the charitable view and allow the repayed money to reduce the loss amount, or (2) craft an exception to the "time of discovery" rule to penalize such a defendant for imposing a risk of loss, and to deter others from doing the same in the future.

A simplified general time of measurement rule might read as follows:

> *Loss should ordinarily be measured at the time the crime is detected.* [NOTE: **Insert following language if desire is to give no credit for funds repaid by thief or embezzler before detection**: *However, if the loss was higher at the time*

the crime was legally complete, the loss should be measured at that time.] *For purposes of this guideline, a crime is detected the defendant knows or has reason to believe that the crime has been detected.*

b) Credits against "loss"

A slightly longer, but one hopes more precise, credits rule might read as follows:

The loss shall be the net loss to the victim(s).

(i) The amount of the loss shall be reduced by the value of money or property transferred to the victim(s) by the defendant in the course of the offense. However, where there is more than one victim, the loss will be the total of the net losses of the losing victims.

(ii) The amount of the loss shall be reduced by the value of property pledged as collateral as part of a fraudulently induced transaction. Where a victim has foreclosed on or otherwise liquidated the pledged collateral before detection of the crime, the loss shall be reduced by the amount recovered in the foreclosure or liquidation. Where a victim had not foreclosed on its security interest in the pledged collateral at the time of detection of the crime, the loss shall be reduced by the fair market value of the pledged collateral at the time of detection.

(iii) With the exception of amounts recovered by a victim through liquidation or foreclosure of collateral pledged by the defendant as a part of the illegal transaction(s) at issue in the case, the loss shall not be reduced by payments made by the defendant to a victim after detection of the crime. With the same exception, loss shall not be reduced by amounts recovered or readily recoverable by a victim from the defendant through civil process or similar means after detection of the crime.

VI. Departure Considerations

A. Upward Departures

1. *Reasonable foreseeability:* In the current guidelines, the departure considerations relating to non-monetary harms (§2F1.1, app. notes 10(a), (c)) both refer to "reasonably foreseeable" harms. For some reason, the analogous provisions in the 2/20/98 draft, app. notes

2(F)(ii), (iii), and (iv), *omit* the foreseeability limitation. Such a limitation is, if anything, more necessary in a regime in which "loss" is expressly defined as reasonably foreseeable harm.

2. *Multiple victims*: My own preference is for a separate enhancement in the guideline itself for multiple victims.[20] However, if consideration of multiple victims is to remain a departure factor, the Commission may wish to give courts some guidance on the meaning of "numerous victims." It seems a term open to numerous constructions.

B. Downward Departures

1. "*Improbable intervening cause*": Application Note 2(G)(iv) permitting downward departure where "loss was substantially increased by an improbable intervening cause" is both unnecessary and a potential source of mischief. If "loss" is by definition limited to reasonably foreseeable harms, then it excludes harm resulting from "an improbable intervening cause." Conversely, if an intervening cause is sufficiently improbable that its effect should be considered only by departure, then it is not reasonably foreseeable. Thus Note 2(G)(iv) is unnecessary. Nonetheless, creative defense counsel will argue at every opportunity that Note 2(G)(iv) applies to their clients. Courts will be compelled by principles of statutory construction to assume that the Commission envisioned a category of reasonably foreseeable, but improbable, intervening causes, and therefore will be obliged to create a distinction which as a matter of logic and of policy should not exist. The core definition of "loss" already deals with the problem Note 2(G)(iv) is intended to address, and does it better. Note 2(G)(iv) should be deleted.

2. "*Inept manner*": See comments above in Section III(B)(2).

3. "*Restitution prior to detection*": If the Commission adopts the rule on credits against

[20] *See Coping With "Loss," supra* at 53-54, 144 (manuscript).

loss from the 2/20/98 draft (Application Note 2(C)), then the downward departure in Note 2(G)(iii) for a defendant who makes "*complete, or substantially complete, restitution prior to the detection of the offense*" is superfluous. Such "restitution" would already be deducted from loss under the credits rule.

VII. CONCLUSION

I believe the Commission can complete a clarifying and simplifying reform of economic crime sentencing this year. Some changes in the 2/20/98 draft will be required. In particular, without significant revisions of the rules governing time of measurement and credits against loss, this proposal will cause more problems than it solves. Likewise, the current definitions of actual and intended loss need some revision, and several of the departure provisions are troublesome. Finally, I believe courts and litigants would be grateful for guidance in the form of definitions of the standard of cause-in-fact and forseeability. If changes in these areas are made, however, the Commission will be able to proceed this year with justifiable confidence that it has fulfilled its mandate.