

Sentencing In Federal Criminal Fraud Cases: Key Issues In Calculating Loss Under U.S.S.G. 2F1.1

By: Gregory Nicolaysen¹

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¹ Mr. Nicolaysen specializes in federal criminal defense litigation and is listed in Martindale-Hubbell under Beverly Hills, Ca. Office address: 8530 Wilshire Blvd., Suite 404, Beverly Hills, Ca. Phone: (310) 854-5135. Email: greg@afda.org

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I. Defining The Issues

- A. The loss analysis should address the following questions, with different outcomes depending on the Circuit in which the defendant is being sentenced:**
- 1. What standard of causation is used: proximate or “but for” causation?**
 - 2. Are the losses at issue direct or consequential results of the defendant’s misconduct, and what effect, if any, will this distinction have on the sentence?**
 - 3. Are there intervening factors that impact on causality, and if so, what effect, if any, will this have on the sentence?**
 - 4. Once a loss amount has been established, is defendant entitled to an offset against loss?**

II. Key Guideline Standards: U.S.S.G. 2F1.1 (1999 edition)

A. Application Note 8:

- 1. “Valuation of loss is discussed in the Commentary to 2B1.1 (Larceny, Embezzlement, and Other Forms of Theft). As in theft cases, loss is the value of the money, property, or services unlawfully taken; it does not, for example, include interest the victim could have earned on such funds had the offense not occurred.”**
- 2. “[I]f 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.”**

B. Application Note 8(c): “Consequential Damages In Procurement Fraud and Product Substitution Cases”:

- 1. “In contrast to other types of cases, loss in a procurement fraud or product substitution case includes not only direct damages, but also consequential damages that were reasonably foreseeable.”**
- 2. “Inclusion of reasonably foreseeable consequential damages directly in the calculation of loss in procurement fraud and product substitution cases reflects that such damages frequently are substantial in such cases.”**

C. Application Note 9:

- 1. For the purposes of subsection (b)(1), the loss need not be determined with precision. The court need only make a reasonable estimate of the loss, given the available information.**

2. *But See, U.S. v. Barnes*, 125 F.3d 1287, 1290 (9th Cir. 1997) (“Although ‘the loss need not be determined with precision’ and a ‘reasonable estimate’ is enough, mere speculation is insufficient.”).

D. Application Note 11:

1. “In cases in which the loss determined under subsection (b)(1) does not fully capture the harmfulness and seriousness of the conduct, an upward departure may be warranted.”
2. “In a few instances, the loss determined under subsection (b)(1) may overstate the seriousness of the offense. This may occur, for example, where a defendant attempted to negotiate an instrument that was so obviously fraudulent that no one would seriously consider honoring it. In such cases, a downward departure may be warranted.”

III. Proximate v. “But For” Causation

- A. Essential question: Does the definition of “loss” under 2F1.1 incorporate a causation requirement, and if so, what does that requirement entail?²
- B. Key Presumption: “[T]he victim loss table in U.S.S.G. 2F1.1(b)(1) presumes that the defendant alone is responsible for the entire amount of victim loss(.)” *U.S. v. Gregorio*, 956 F.2d 341, 346 (1st Cir. 1992)
- C. Strategic Pointer: In white collar cases, it is common to address loss issues under 2F1.1 as well as restitution issues. Many times, the dollar figures for loss and restitution are close, if not identical. But there is a potential trap for defense attorneys: it is important to keep in mind that the method of calculating loss for 2F1.1 purposes is different from the method for restitution. Thus, we should be careful *not* to cite restitution-related cases when we are presenting an argument re: loss calculation under 2F1.1. See, *U.S. v.*

² Note: the cases cited in this section of the outline address the issue of causation in a manner that is quite close to the analysis set forth in cases cited in other sections of the outline discussing the issues of consequential damages and offset. In creating an outline format for circuit rulings on loss calculations under 2F1.1, it is difficult to categorize circuit rulings by topic (causation, consequential damages, offset, etc) because the lack of guidance in the Guideline Manual on the definition of “loss” has resulted in a wide variety of circuit rulings that lack any neat categorization. This outline attempts to provide a working framework as an educational aide in teaching seminars.

Catherine, 55 F.3d 1462, 1465-66 (9th Cir.1995); U.S. v. Smith, 944 F.2d 618 (9th Cir.1991).

1. In U.S. v. Janusz, 135 F.3d 1319, 1324 (10th Cir.1998), the Circuit “distinguished the restitution calculation, which measures the net amount owed to victims at the time of calculation, from the intended loss calculation, which measures, for sentencing purposes, ‘the magnitude of the crime at the time it was committed.’” [discussed in U.S. v. Burrridge, 191 F.3d 1297, 1301 (10th Cir. 1999)]

D. Seventh Circuit Expressly Requires Proximate Causation

1. U.S. v. Marlatt, 24 F.3d 1005 (7th Cir. 1994)
 - a. Very important ruling which articulates the Seventh Circuit’s rejection of a “but for causation” standard in favor of a proximate causation standard, thus excluding consequential damages from the loss calculation, *even where those damages were foreseeable*.
 - b. **Brief Statement Of Holding:** “the proper measure of loss was only the cost of clearing titles to property the defendant had falsely represented to purchasers as lien-free, not the cost to the title company of buying the properties from the disgruntled purchasers.” U.S. v. Gottfried, 58 F.3d 648, 651 (D.C. 1995) (discussing Marlatt)
 - c. **KEY POINT:** Marlatt is a leading case for two key propositions:
 - (1) Consequential damages are excluded from loss calculation, regardless of foreseeability;
 - (2) Although a defendant's fraud may be a "but-for" cause of such damages, they are not generally included as loss under section 2F1.1(b)(1). [cited with approval in U.S. v. Morris, 80 F.3d 1151, 1174 (7th Cir. 1996)].
 - d. **Facts:** Defendant was the owner of a local title company who bought a resort property and secured the title insurance policies on time share units at the resort by making misrepresentations to the title company, Tigor Title, regarding the existence of liens/encumbrances. He converted the property into time shares and sold them to buyers who relied on the assurances of clear title. When Tigor discovered the fraud, it spent \$476,000 to clear the titles, but by then the market value of the units had plummeted. Later, in response to threats of lawsuits from the purchasers, Tigor spent an additional \$565,000 to repurchase all of the

units sold and thereby avoid litigation.

- e. **Circuit:** Ruled in favor of defense on loss issue, finding that the loss was the \$476,000 paid by Ticor to remove the liens/encumbrances. The \$565,000 spent to repurchase the units and avoid litigation was not part of the 2F1.1 loss.
- f. **Key language from the opinion on causation (page 1007):**

The purchasers were not happy. The resort had closed, and for this and perhaps other reasons their condos were worthless, however spic and span the titles to them. The purchasers had sustained a loss; Ticor had a deep pocket; Ticor's agent had committed a fraud; the temptation to sue was therefore great. The loss was not a consequence of the fraud, however, other than in the sense, irrelevant here as we shall explain, of "but for" causality. Ticor had made good the only loss caused in a legal sense by the defendant's fraudulent concealment of the defects in the titles it had insured. We do not know the cause of the loss of which the purchasers complained. It may have been a collapse of the local recreational real estate market, business mistakes by the defendant, some unrelated fraud by the defendant, or a completely extraneous event. All we know for sure is that the loss in value was not caused by the defective titles. For after the defects were removed, the loss remained. The fact that the purchasers would not have purchased the time shares had it not been for the title insurance policies issued by Ticor would not make Ticor an insurer against a drop in the real estate market. [citations omitted] That is the difference between "but for" causation and the causation--for which the presence of but-for causation is ordinarily a necessary condition but rarely a sufficient one--that imposes legal liability. The distinction runs throughout the law. Criminal law is no exception. A man rapes a woman and she is hospitalized. Her injuries are not serious but the hospital burns down and she dies. The rapist would not be responsible for the death, because the rape did not make it more likely that the victim would die as a result of a fire. The rape therefore did not, in either a legal or an ordinary-language sense, "cause" her death, though she would not have died in the hospital fire but for the rape.

- g. **Key language from the opinion on consequential damages (opinion at 1007):**

Application Note 7(b) distinguishes between loss on the one hand and consequential and incidental damages on the other and makes clear that

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with irrelevant exceptions the latter two items are not to be counted in computing loss for purposes of sentencing under this guideline. The reason for the distinction is no doubt to prevent the sentencing hearing from turning into a tort or contract suit. The distinction is nicely illustrated by this case. The defendant extracted from Ticor by fraud a bunch of insurance policies on which Ticor was required to make good to the tune of \$476,000. This was the loss. In the wake of the loss Ticor incurred other expenses, **which were consequences, perhaps even foreseeable consequences**, of the fraud, but were not the thing actually taken from Ticor, the loss; the thing taken was the promise to insure and the cost of honoring that promise was \$476,000. [emphasis added]

(1) See also, U.S. v. Santiago, 977 F.2d 517, 525-26 (10th Cir.1992).

2. Marlatt cited with approval in:

- a. U.S. v. Vitek Supply Corp., 144 F.3d 476, 488 (7th Cir. 1998)[“That case . . . reiterates the unsurprising requirement that a defendant must have legally caused a loss before he can be held accountable for it(.)”].
- b. U.S. v. Green, 114 F.3d 613, 617 (7th Cir. 1998)(“All direct damages are to be included in the loss calculation, but consequential or incidental damages are not to be counted as damages for loss calculation purposes.”).
- c. U.S. v. Morris, 80 F.3d 1151, 1173 (7th Cir. 1996)(key case discussing causation in depth, including the concept of intervening factors).

3. It is worth noting how the Seventh Circuit subsequently distinguished Marlatt in U.S. v. Barrett, 51 F.3d 86, 89-91 (7th Cir. 1995)(on facts similar to those in Marlatt, defendant did not prevail because he committed two distinct frauds within the overall scheme; and losses that were consequential to his conduct as to one fraud victim were direct as to the other victim. Accordingly, all the losses were properly included in loss calculation under 2F1.1.).

E. Third Circuit: important cases that address causation issue in calculating actual loss:

1. U.S. v. Daddona, 34 F.3d 163, 170-72 (3d Cir.), *cert. denied*, --- U.S. ----, 115 S.Ct. 515 (1994).
 - a. Consistent with Marlatt. Basic facts: real estate developer procured fraudulent mortgage loan to develop properties.
 - b. Held: “defendants' unauthorized issuance of performance and payment bonds on a construction project defrauded the insurer and caused losses to it and perhaps to subcontractors who had unsatisfied claims, but the "loss" under the Guidelines did not also include the costs of completing the project.” U.S. v. Gottfried, 58 F.3d 648, 651 (D.C. 1995) (discussing Daddona)
 - c. Thus, defendant should have been held liable only for that portion of loss due to his fraud, since the “excess cost to complete the project was a consequence of the victim’s involvement with the general contractors, and that portion of the loss was not actually taken from victim as a result of defendants’ fraudulent activities.” (Opinion at 170-172)
2. U.S. v. Needle, 72 F.3d 1104 (3d Cir. 1995)
 - a. Majority Opinion (discussed later in outline under “Intervening Factors”)
 - b. Becker, J., concurring and dissenting:
 - (1) This is an important analysis for defense attorneys.
 - (2) Strongly objects to the majority’s conclusion as to the determination of loss and provides an in-depth analysis in support of view that “the Guidelines require a finding of causation before a harm may be used as loss for purposes of section 2F1.1. The causation requirement, pervasive in the criminal law, . . . is made explicit in the language of the Guidelines and is buttressed by case law and policy considerations.” [Page 1113]. “[T]he plain meaning of 'resulted from' connotes causation.” [Page 1114]. “I also note that this Court and others have repeatedly suggested the need for finding causation in making a loss determination.” [Page 1118]

(Citations omitted).”

3. U.S. v. Evans, 155 F.3d 245, 253 (3d Cir.1998) (“[T]he actual loss determination must be predicated on the harm *caused by* [defendant’s] offenses.”) [emphasis added].
4. U.S. vs. Yeaman, 194 F.3d 442, 457 (3rd Cir. 1999) (in wire fraud / securities fraud case, court rejects defense argument that defendant’s conduct caused no actual loss, citing Evans and Needle; reverses district court on government’s appeal).
 - a. *Key*: Circuit finds it unnecessary to determine whether a particular defendant’s conduct caused a specific loss because the subject crime involved jointly undertaken activity, which makes each defendant liable for the losses caused by the other co-participants under 1B1.3(a)(1)(B). [opinion at 458]
 - b. *Strategic Pointer*: if you represent a defendant in a conspiracy case and seek to limit the amount of actual loss at sentencing based on a causation theory, watch out for the “jointly undertaken activity” standard that will make your client vicariously liable for the losses caused by the co-participants.

IV. Direct v. Consequential Damages

A. Defined

1. U.S. v. O’Brien, 119 F.3d 523, 536 n.9 (7th Cir. 1997): “Consequential damages are defined as ‘damage, loss or injury as does not flow directly and immediately from the act of the party, but only from some of the consequences or results of such act.... Damages which arise from intervention of special circumstances not ordinarily predictable.’ Black’s Law Dictionary, at 390 (6th ed.1990).”

B. Sentencing Guidelines

1. The commentary to 2F1.1 describes “loss” as “the value of the money, property, or services unlawfully taken.”
 - a. incorporates by reference the discussion of loss valuation contained in commentary of 2B1.1);
 - b. 2B1.1: ‘Loss’ means the value of the property taken, damaged, or destroyed”).

2. Thus, on its face the definition of loss is centered on the value of the thing taken, without reference to consequential or incidental losses.
3. Other sentencing guideline provisions that suggest consequential losses are not to be taken into account in calculating loss:
 - a. 2F1.1 commentary n. 7: loss "does not include interest the victim could have earned ... had the offense not occurred."
 - b. 2F1.1 commentary n. 2: "when property is taken or destroyed, the loss is the fair market value of the particular property at issue."
4. However, the guidelines do note specific instances when consequential losses may properly be considered:
 - a. Commentary to 2F1.1: "[i]n contrast to other types of cases, loss in a procurement fraud or product substitution case includes not only direct damages, but also consequential damages that were reasonably foreseeable."
5. The issue of foreseeability must be viewed not only in the context of 2F1.1 / 2B1.1, but also in the context of 1B1.3, the Relevant Conduct guideline, which holds a defendant responsible for all losses, *foreseen or unforeseen*, that result from the defendant's actions, or the *foreseeable actions of his cohorts* in a jointly undertaken activity.
6. As the cases cited in this outline demonstrate, there is no consensus between the circuits (or even within certain circuits) in regard to whether the doctrine of foreseeability is to be applied so as to include in the loss calculation certain dollar amounts that would otherwise be rejected as consequential damages. In presenting loss arguments to the court, defense counsel need to be aware of the lack of clarity *in both the guidelines and the case law* as to:
 - a. What constitutes direct v. consequential damages
 - b. What role, if any, the doctrine of foreseeability plays in this analysis in your Circuit.

C. *Strategic Pointer:*

1. "... the fact that the Sentencing Commission prescribed consequential losses in only (procurement fraud / product substitution) fraud cases, and not others, is strong evidence that consequential damages were omitted from the general loss definition by design rather than mistake." U.S. v. Izydore, 167 F.3d 213, 223 (5th Cir. 1999) [discussed below].

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2. Note the following language from U.S. v. Ortland, 109 F.3d 539, 547 (9th Cir. 1997): “[i]f the Sentencing Commission had intended to include consequential losses, it could have included them in the definition of loss.”
3. Circuit courts holding that only direct losses count under 2F1.1 and that consequential losses, therefore, are typically *not* counted:
 - a. U.S. v. Green, 114 F.3d 613, 617 (7th Cir. 1997), citing U.S. v. Marlatt, 24 F.3d 1005, 1007-08 (7th Cir.1994);
 - b. U.S. v. Daddona, 34 F.3d 163, 171-72 (3^d Cir.), *cert. denied*, 513 U.S. 1002 (1994) (held: defendants' unauthorized issuance of performance and payment bonds on a construction project defrauded the insurer and caused losses to it and perhaps to subcontractors who had unsatisfied claims, but the "loss" under the Guidelines did not also include the costs of completing the project.);
 - c. U.S. v. Newman, 6 F.3d 623, 630 (9th Cir.1993) (applying 2B1.1) (held: the loss caused by the defendant arsonist was only the value of the property destroyed by the fire, not the costs of putting the fire out.)
 - (1) *key language*: “[The measure of loss] does not include consequential losses. If the Sentencing Commission had intended to include consequential losses, it would have included them in the definition of loss.” (Opinion at 630)
 - d. U.S. v. Wilson, 993 F.2d 214, 217 (11th Cir.1993) (applying 2F1.1, 2B1.1) (held: the loss consisted only of the fees the defendant fraudulently took from would-be borrowers, not the amount of loans the defendant falsely promised to obtain for his victims.)
 - (1) *key language*: “The phrase 'property taken, damaged or destroyed' does not allow for inclusion of incidental or consequential injury, and it is error to rely on evidence of such injury in calculating loss when the value of the property may be ascertained.” (Opinion at 217)
 - e. U.S. v. Thomas, 973 F.2d 1152, 1159 (5th Cir.1992)
 - f. *But See*, U.S. v. King, 915 F.2d 269, 272 (6th Cir.1990) (holding that foreseeable consequential damages are to be considered in valuing loss)

D. Ninth Circuit Cases:

1. **The Ninth Circuit has yet to promulgate a clear, consistent doctrine regarding loss calculation. The Ortland case seems to clearly acknowledge that consequential damages are not to be considered in determining loss, yet the opinion leaves open the issue of how to differentiate between direct and consequential loss. Adding to the uncertainty of the Ninth Circuit's position are the rulings in Sablan and Sarno, which are not easily reconciled yet seem joined by a refusal to base loss calculation on foreseeability. Other Ninth Circuit cases provide a completely different standard by enunciating the so-called Economic Reality Doctrine, which looks more to practicality than to a technical causation analysis.**
2. **U.S. v. Sablan, 92 F.3d 865 (9th Cir. 1996)**
 - a. **Facts: defendant, a former employee of a bank, who had recently been fired for circumventing security procedures, entered the closed bank with a key she had kept, went to her former work site, and accessed the computer, resulting in damage to several bank files. Pled guilty to computer fraud.**
 - b. **District Court: Loss included cost of repairs and other work required to restore the bank files to their original condition, including \$13,000 in programming and \$15,000 in associated costs, for a total of \$28,000 (i.e., loss between \$20 - 40,000). [Page 869]**
 - (1) **District Court calculated the loss based on: the bank's standard hourly rate for its employees' time; computer time; and administrative overhead – the same rate that the bank uses in charging customers.**
 - c. **Circuit affirms in part / reverses in part:**
 - (1) **Approves the District Court's analysis summarized above, commenting: "The district court calculated the cost of repairs based upon the bank's standard hourly rate for its employees' time, computer time, and administrative overhead-the same rate that the bank uses in charging paying customers. Sablan complains that this was improper because of the profit margin and administrative overhead that is built into these charges. However, had the bank hired an outside contractor to make the repairs these factors would have been built into the charges. Similarly, had it not been necessary for the bank to devote its**

employees' time and computer time to making these repairs, the administrative overhead and profit would have been paid to the bank by its normal customers. The utilization of the normal bank charges in valuation of the loss was a reasonable approach by the district court." [Page 869]

- (2) In dictum, quoted below, the Circuit hints that it supports a proximate causation standard by excluding, under the consequential damages concept, certain costs incurred by the bank during the period in which it was repairing the damage inflicted by defendant. The exclusion of these costs, viewed in conjunction with the affirmance of the remainder of the District Court's loss calculation, suggests that the Circuit will limit the loss analysis to those expenses that directly and proximately flow from the defendant's fraud.
 - (3) The opinion states as follows: the defendant "objects to the inclusion in the calculation of \$4,000, which reflect the value of a meeting of bank managers with the FBI, \$1,000 for a staff meeting to discuss the incident, and \$350 for the handling of crank calls during the repair time. These expenses, while probably foreseeable, were not required to repair the damage. Thus, they were consequential losses. . . However, we need not consider this matter in this case because even deducting the \$5,350 in consequential damages from the \$28,252.38 calculated by the district court, the remaining balance exceeds the \$20,000 specified for the four-level enhancement." [Page 869]
 - (4) Circuit reverses due to error by District Court in including consequential damages in restitution order. (Page 870)
3. U.S. v. Ortland, 109 F.3d 539, 547-48 (9th Cir.), *cert. denied*, 522 U.S. 851 (1997):
- a. Language helpful to the defense:
 - (1) Guideline § 2F1.1 governs valuation of loss in a fraud case. The 1994 version refers to the theft loss guidelines, § 2B1.1. See USSG § 2F1.1, comment. (n.7). We have reasoned that valuation under the theft loss Guideline, § 2B1.1, does not include consequential damages. U.S. v. Newman, 6 F.3d 623, 630 (9th Cir.1993). In Newman, we ruled that the sentencing

court improperly considered the cost of arson fire-suppression and should only have considered the amount of property damage caused by the arson. Id. We said that calculation of consequential damages for arson or theft (fn omitted) "would be too complex and would not necessarily reflect the defendant's culpability accurately." Id. Moreover, "[i]f the Sentencing Commission had intended to include consequential losses, it could have included them in the definition of loss.

b. But note the court's narrow reading of the term "consequential" *so as to make seemingly consequential losses end up being treated as part of the "direct" losses* and thus properly fall under the 2F1.1 loss calculation:

(1) On the other hand, we have rejected a claim that all somewhat indirect fraud losses are the type of "consequential" damages that cannot not be considered under § 2F1.1. In U.S. v. Mende, we found that the claimed actual losses were a direct result of the defendant's conduct and thus were not barred as consequential damages. 43 F.3d 1298, 1302-03 (9th Cir.1995). . . . We disagreed and held that the district court's finding that the defaulted loans were the direct result of the defendant's fraud and were not consequential was not a clearly erroneous determination. Id. at 1303.

(2) In this case, the frauds were used to extract funds from the investors for purchase of partnership interests, and only a portion of the funds was repaid. In order to obtain repayment, certain fees and costs were incurred and came out of the recovery, or so the district court could properly determine, as it did. Thus, there were no consequential damages at all; the actual loss to the investors was simply what they did not recover partnership. There is nothing "consequential" about that; it is part of the direct loss.

4. Other Ninth Circuit cases worth noting:

- a. U.S. v. Shaw, 3 F.3d 311, 312-14 (9th Cir.1993);
- b. U.S. v. Shattuck, 961 F.2d 1012, 1016-17 (1st Cir.1992)

5. "Economic Reality" Doctrine

- a. **U.S. v. Allison**, 86 F.3d 940, 943-44 (9th Cir. 1996)(most frequently cited case for “Economic Reality” doctrine. Credit card fraud case. Holds that in calculating the loss in fraud cases, the sentencing court should take a realistic approach to determine what losses the defendant truly caused, rather than the use of some approach which does not reflect the monetary loss).
 - (1) **Cf. U.S. v. Sowels**, 998 F.2d 249, 251 (5th Cir. 1993), *cert. denied*, 510 U.S. 1121 (1994) (Does not apply “Economic Reality” approach in credit card case. Holds that where defendant stole credit cards, he put fraud victims at risk of losing entire amount of credit available, so use of credit limits of cards was reasonable estimate of intended loss).
- b. **U.S. v. Harper**, 32 F.3d 1387, 1392 (9th Cir. 1994)(promulgated the “Economic Reality” doctrine for the first time in Ninth Circuit);
- c. **U.S. v. Riley**, 143 F.3d 1289, 1291 (9th Cir. 1998)(rejects “Economic Reality” approach in tax fraud case). Note the following discussion of **Harper and Allison**: “As **Harper** and other similar cases make clear, however, the economic reality approach is simply one means of arriving at a fair measure of the actual or intended loss. The approach is particularly useful in certain types of fraud cases in which the value of the property obtained, or sought to be obtained, by means of the fraud bears little or no relation to the amount of loss the defendant actually inflicted or intended to inflict. (FN1) See, e.g., **U.S. v. Allison**, 86 F.3d 940, 944 (9th Cir.1996) (calculating the loss from credit card fraud by subtracting payments the defendant made to the credit card accounts). In those fraud cases, the intended losses cannot be calculated as in theft cases, that is, by simply looking at the value of the object of the fraud. Instead, the intended loss calculation requires a more sophisticated examination of other factors, including the amount of actual loss. In any event, the objective under the economic reality approach is to arrive at a fair assessment of the loss the defendant actually inflicted or intended to inflict, as contemplated by the guidelines.” (Page 1291)

E. Appellate Review

1. The question whether a certain financial figure is to be considered a "loss" under 2F1.1 is a legal question involving the correct interpretation of the Sentencing Guidelines that the Circuit reviews de novo. See, **U.S. v. Randall**, 157 F.3d 328, 330 (5th Cir.1998) (district court's interpretation and application of 2F1.1 is

reviewed de novo); U.S. v. Vitek Supply Corp., 144 F.3d 476, 488 (7th Cir.1998) (observing that meaning of "loss" under 2F1.1. is a question of law reviewed de novo).

F. RECENT CIRCUIT RULINGS: 1998 - 1999

1. U.S. v. Davoudi, 172 F.3d 1130 (9th Cir. 1999)

- a. Fraudulent loan case.
- b. No consequential damages allowed for calculation of restitution under 18 U.S.C. 3663. (See also U.S. v. Stoddard, discussed below).
- c. But consequential damages allowed in calculation of loss under 2F1.1:
 - (1) "loss calculations under § 3663 and USSG § 2F1.1 are distinct." (Page 1135)
 - (2) 2F1.1: "[i]n fraudulent loan application cases the loss is the amount of the loan not repaid *at the time the offense is discovered*, reduced by the amount the lending institution has recovered (or can expect to recover) from any assets pledged to secure the loan." (Page 1135)
 - (3) "If the bank suffers losses after the offense is discovered because of a falling market or even through its own improvident management, those **consequential losses** can be attributed to the defendant's conduct for purposes of Guidelines sentencing." (Page 1135)

2. U.S. v. Stoddard, 150 F.3d 1140 (9th Cir. 1998)

- a. Fraud by bank officer against Office of Thrift Supervision.
- b. Held: Restitution order may not include consequential expenses.
- c. Opinion provides detailed explanation of prior 9th Circuit ruling in U.S. v. Allison, 86 F.3d 940, 943 (9th Cir.1996), regarding how to calculate loss under 2F1.1, specifically as to the Economic Reality test.
- d. Key language from opinion (page 1147):
 - (1) Restitution in a criminal case is authorized by the Victim and Witness Protection Act, codified at 18 U.S.C. §§ 3663-64. "[R]estitution can only include losses directly resulting from a defendant's offense." U.S. v. Sablan, 92 F.3d 865, 870 (9th Cir.1996). For that reason, "a restitution order must be based on losses directly resulting from the defendant's criminal conduct." Id. at 870. Consequential expenses may not be legally included in an order of restitution. Id. Restitution can

only be based on actual loss. U.S. v. Catherine, 55 F.3d 1462, 1464 (9th Cir.1995) ("Loss under 18 U.S.C. § 3663 is the actual loss.").

3. U.S. v. Izydore, 167 F.3d 213 (5th Cir. 1999)

- a. Bankruptcy fraud / wire fraud case arising from defendants' dealings with financially-troubled company that sought capital from defendants to pay creditors and fund its reorganization plan.
- b. Held: Bankruptcy trustee fees are not consequential damages.

c. Key language from opinion (Pages 223-224):

(1) The touchstone for determining loss under 2F1.1 is the "value of the thing taken." That concept is the key measure because the Sentencing Commission believed that punishment for fraud should reflect a balance between the loss to the victim and the gain to the defendant. See 2B1.1 commentary background ("The value of property stolen plays an important role in determining sentences for theft and other offenses involving stolen property because it is an indicator of both the harm to the victim and the gain to the defendant"). It was a "compromise between the retributive goals of punishment, which might have been advanced best by basing sentence solely on the injury to the victim, and its deterrent function, which might have been advanced best by determining sentence solely from the offender's gain. U.S. v. Wilson, 993 F.2d 214, 217 (11th Cir.1993).

(2) In this case, over the course of the appellants' unlawful conduct Marhil was robbed of its capital, and post-petition creditors were defrauded. There can be no doubt that this money was "taken" by the appellants, as that word is commonly understood. The trustee's fees, on the other hand, were incurred after the appellants' unlawful conduct had ended. And while it is true that the trustee's fees were a consequence of the appellants' unlawful conduct, mere "but for" causation is not the litmus test for loss determinations under U.S.S.G. 2F1.1. See Marlatt, 24 F.3d at 1007 (expressly recognizing this point). The appropriate measure is the value of the thing taken, and under that standard we cannot reasonably conclude that trustee's fees were the "thing taken" from Marhil. Accordingly, we find that the district court erred in including the trustee's fees in its loss

calculations.

4. U.S. v. Akbani, 151 F.3d 774 (8th Cir. 1998)
 - a. Bank fraud: Check-kiting scheme
 - b. Held: restitution order may include the bank's attorneys' fees as an item of consequential damages under 18 U.S.C. 3663. (Page 779)

5. U.S. v. Randall, 157 F.3d 328 (5th Cir. 1998)
 - a. Facts: defendant acquired several rental properties through HUD and VA loans, subsequently defaulted and filed bankruptcy. Pled guilty to bankruptcy fraud.
 - b. District Court: included in the loss calculation the loss sustained by HUD and VA in disposing of the properties after defendant defaulted.
 - c. Circuit: reversed for defendant. These losses were *not caused by defendant's fraudulent conduct*. The various fees and expenses would have been incurred in any foreclosure, regardless whether a bankruptcy petition was filed or whether bankruptcy fraud occurred.

V. **Intervening Factors: Loss Caused By Actions Or Events Beyond The Defendant's Control**

A. **General Rule:** courts refuse to deduct from the total loss to the victim those losses that were caused by actions or events beyond the defendant's control.

1. But a downward departure may be available.

B. Examples of cases that apply the general rule (note that the Seventh Circuit has been particularly active in this area):

1. **U.S. v. Sarno**, 73 F.3d 1470 (9th Cir. 1995)

a. **Multi-defendant conspiracy case re: knowingly making false statements to federally insured bank.**

b. **District Court:** Calculated actual loss by including losses caused by co-defendants, rejecting one defendant's claim that those losses were unforeseeable and caused by factors beyond his control.

c. **Circuit:** affirmed the loss calculation (reversed/remanded on other grounds): all losses on fraudulently-procured loan were attributable to the defendant even where the default was not his fault; it was reasonably foreseeable from the defendant's conduct that the loan would be approved, putting the bank's money at risk.

d. Key language from opinion, at page 1500: "A sentence calculated pursuant to the loss tables of Sec. 2F1.1 is properly based on actual loss notwithstanding the fact that this loss may be greater than the intended, expected, or foreseeable loss (Citations omitted) Thus, '[a]ny portion of the total loss sustained by the victim as a consequence of factors extraneous to the defendant's criminal conduct is not deducted from total 'victim loss' prior to the determination of the applicable guideline sentencing range pursuant to U.S.S.G. 2F1.1(b)(1)." (Citations omitted). Rather, the defendant may seek a **downward departure** to mitigate distortions occasioned by forces beyond the defendant's control." [emphasis added] [Page 1500]

(1) See Application Note 11 to 2F1.1: the court may depart downward if the total loss calculation overstates the seriousness

of the offense.

2. U.S. v. Miller, 962 F.2d 739, 742-44 (7th Cir. 1992)(establishes the “intervening cause rule” in the Seventh Circuit: holds that neither the intervening acts of a negligent third party nor the victim's own failure to mitigate damages could provide a basis for reducing loss), cited with approval in U.S. v. Morris, (see below) 80 F.3d at 1171.
3. U.S. v. Barrett, 51 F.3d 86 (7th Cir. 1994)(loss calculation was not reduced by the amount lost due to the poor real estate market).
4. U.S. v. Berkowitz, 927 F.2d 1376 (7th Cir.), *cert. denied*, 502 U.S. 845 (1991)(loss calculation was not reduced by government’s failure to mitigate costs of replacing investigation documents defendant had destroyed, since victim had no obligation to mitigate damages), cited with approval in Miller, *supra*, 962 F.2d at 744. *Accord: U.S. v. Gottfried*, 58 F.3d 648, 651 (D.C. 1995) (citing Berkowitz with approval)
5. U.S. v. Neadle, 72 F.3d 1104, 1110 (3d Cir.1995) (“it is not appropriate to reduce the amount of the loss, as computed under the Guidelines, in order to reflect other causes of the loss which were beyond the defendant's control.”);
6. U.S. v. Stedman, 69 F.3d 737, 740-41 (5th Cir.1995)(Circuit refuses to reduce loss based on intervening factor of bank’s troubled financial condition, rejecting defendants’ contention that “the sentencing court must determine the loss amount for which their wrongful conduct was the sole cause, and use only that amount in sentencing.”).

C. Downward Departure As Remedy For Intervening Cause

1. Starting Point: U.S.S.G. 2F1.1 (1999 ed.), comment (n. 11): “a downward departure may be warranted” where the loss calculated in the Loss Table “may overstate the seriousness of the offense.”
2. U.S. v. Sarno, 73 F.3d 1470, 1500 (9th Cir. 1995) [discussed earlier]
3. U.S. v. Morris, 80 F.3d 1151, 1171-72 (7th Cir. 1996)

- a. Key case to be aware of, particularly if you are intending to cite Marlatt – note that they are both from the same circuit.
- b. **Facts:** defendants were bank directors who chose not to approve additional loan loss reserves for the bank’s loan portfolio, but to obtain only those reserves necessary to cover losses identified in the loan portfolio. (Page 1155). This allowed the bank to issue a new offering circular which described the loan reserves as adequate, and induced investors to purchase the offering. Ultimately, the bank’s financial condition deteriorated, and the bank was placed in conservatorship. The offering became worthless, and the investors lost all. The bank eventually went out of business. (Page 1157)
- c. **Circuit:** Affirms district court’s rejection of defendants’ position that factors beyond their control had contributed to the bank’s failure and the victims’ losses.
 - (1) **Intervening factors do not justify a reduction in loss -- only remedy is downward departure:** “Even if defendants' fraud may not have caused Germania's ultimate demise, just as the defendants' fraudulent representations in Miller did not actually cause the depreciation in value of the mortgaged property, the existence of intervening causes does not provide a basis for reducing the amount of loss under section 2F1.1(b)(1). Miller, 962 F.2d at 744; see also id. at 748 (Flaum, J., concurring); Kopp, 951 F.2d at 531. The existence of other possible causes of that loss would only provide a basis for a downward departure under the application note.” (Page 1172)
 - (2) distinguishes Miller from Marlatt in rejecting defendant’s request to reduce loss due to factors outside his control. **Key language:** “Even if intervening forces ultimately contributed to Germania's demise, the thing actually taken from defrauded investors was still the face amount of the Schnotes, and that amount is thus directly charged to defendants under section 2F1.1. That is the import of this circuit's Miller decision, which finds consistent support in the law of other circuits. See also U.S.S.G. § 2F1.1, App. Note 11 (where a defendant makes misrepresentations in a securities offering that enable securities to be sold at inflated prices, the loss to the victim is the subsequent loss in value even if attributable in substantial part to other causes). Marlatt applies, by contrast, where a victim

loses not only the thing actually taken by virtue of the defendant's fraud (i.e., the direct loss), but also suffers consequential or incidental damages. **Although a defendant's fraud may be a "but-for" cause of such damages, they are not generally included as loss under section 2F1.1(b)(1).** See 24 F.3d at 1007-08; see also Barrett, 51 F.3d at 91. (FN17) The present case is controlled by Miller, not Marlatt. The district court therefore properly interpreted the meaning of "loss" under section 2F1.1 and did not clearly err in estimating the amount of that loss. (Pages 1172-73)(Emphasis Added)

4. U.S. v. Kopp, 951 F.2d 521, 531-36 (3d Cir.1991)(observed that in Application Note 11, the Sentencing Commission "definitively rejected adjusting the 'loss' itself downward to reflect other causes beyond the defendant's control.... To the extent [the] actual loss had other, more proximate causes, a discretionary downward departure--but not a mandatory 'loss' adjustment--might be appropriate."), cited with approval in U.S. v. Morris, supra at 1171;
 - a. Note 1: the Kopp decision is analyzed in depth in Judge Becker's dissent in U.S. v. Needle, supra, 72 F.3d at 1117.
 - b. Note 2: on a separate matter, it is important to note that subsequent to the Kopp decision, the Sentencing Commission amended Application Note 8 to 2F1.1 so as to expressly exclude interest from the calculation of loss. The amendment went into effect November 1, 1992.
 5. U.S. v. Gregorio, 956 F.2d 341, 345 (1st Cir. 1992)(Circuit affirms district court's decision to credit defendant for loss amount beyond his control by granting downward departure; defendant had requested a reduction in loss calculation under 2F1.1 based on intervening cause).
 6. U.S. v. Reeder, 170 F.3d 93, 109 (1st Cir. 1999) (cites Gregorio with approval for proposition that "whatever distortive effects extraneous causes may have had on the total "victim loss" calculation may warrant a departure from the applicable guideline sentencing range.").
- D. *Strategic Pointer*: defense attorneys must avoid the trap of arguing that a certain amount of the loss was attributable to factors outside the client's control and that the loss calculation should be reduced accordingly. The case law suggests that it makes better sense to argue

1. that the loss amount at issue is a consequential loss, rather than a direct loss. By shifting the argument in this way, we can apply the cases cited above that exclude consequential damages, even if they are foreseeable.
2. that the court should grant a downward departure to adjust the loss amount due to the intervening cause.

VI. Offsets Against Loss For Economic Benefits Transferred To The Victim

A. **General Rule:** An offset against loss is generally given to the defendant under 2F1.1 for economic benefits transferred to the victim(s) that occur prior to detection of a fraud.

1. However, this rule is often not applied in theft cases under 2B1.1.
2. **Strategic Pointer:** In a case where defense counsel is seeking an offset against loss under 2F1.1, it is important to object to any analogies to the theft guideline because the concept of offset is unique to fraud and does not apply in the same way to theft.
 - a. On this point, note the following excerpt from U.S. v. Tatum, 138 F.3d 1344, 1345 (11th Cir. 1998):

However, this case does not involve a simple theft. Rather, this case has been litigated upon the assumption by all of the parties (and the district court) that the crimes involved were not simple theft, but rather were in the nature of the fraudulent procurement of a contract. . . . [T]he analysis in a case of fraud is not as simple as in a case of simple theft. In a simple theft, there is almost always an intent to deprive the victim of the value of the property taken. Thus, it is appropriate to allow no reduction for the recovery of any portion of the stolen property. In some cases of fraud, there will be a similar intent to deprive the victim of the full amount fraudulently taken. However, in other cases of fraud, the perpetrator may intend no loss. Appellants argue that their crimes fall in the latter category. [footnotes omitted]

- b. See also, U.S. v. Kopp, 951 F.2d 521 (3rd Cir. 1991); U.S. v. Schneider, 930 F.2d 555 (7th Cir. 1991)

B. **Strategic Pointer:** it is important for defense counsel to focus on the *net* loss and challenge any calculation that is based on the gross amount of loss:

1. U.S. v. Parsons, 109 F.3d 1002, 1004 (4th Cir. 1997): Circuit reverses sentence in fraud case, holding that district court failed to apply net loss. Circuit offsets loss by amount of funds that defendant lawfully obtained (in this case, moving expense funds).

2. The following excerpt from the Parsons opinion is key:

Nor is loss typically measured by the gross amount involved in the fraudulent scheme. See United States v. Mount, 966 F.2d 262, 265 (7th Cir. 1992) (Section 2F1.1 "call[s] for the court to determine the net detriment to the victim rather than the gross amount of money that changes hands."). Rather, whatever value the victim received is set off against the entire amount paid in evaluating the loss. When an item's value is fraudulently inflated, loss is the amount the item was overvalued, not the entire amount paid: "Where, for example, a defendant fraudulently represents that stock is worth \$40,000 and the stock is worth only \$10,000, the loss is the amount by which the stock was overvalued (i.e., \$30,000)." U.S.S.G. § 2F1.1 comment 7(a). Similarly, "[i]n a case involving diversion of government program benefits, loss is the value of the benefits diverted from intended recipients or uses." U.S.S.G. § 2F1.1 comment 7(d). Loss is not the total amount of the benefits the defendant received, because some benefits may be rightfully due; instead, loss is measured by the amount diverted from proper purposes.

We have consistently followed this approach in determining the correct measure of loss for guidelines purposes. For example, in United States v. Adam, 70 F.3d 776 (4th Cir. 1995), and United States v. Castner, 50 F.3d 1267 (4th Cir. 1995), we found that the defendant's misconduct--medicare fraud in Adam and Naval procurement fraud in Castner--caused a loss to the United States. We did not, however, count as a loss the entire amount paid for medicare treatments in Adam, or the entire contract amount in Castner. Rather, we used the profit made by each defendant as a proxy for the loss. Adam, 70 F.3d at 781-82; Castner, 50 F.3d at 1276. We found the profit a fair estimation of loss because the Government did receive some benefit for the money paid to the defendants, but did not receive a benefit for "the amount of money unlawfully taken--the illegal profit." Castner, 50 F.3d at 1276.

3. U.S. v. Tatum, 138 F.3d 1344, 1345 (11th Cir. 1998) (in procurement fraud case, Circuit reverses district court's calculation of loss based on gross receipts).

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4. **U.S. v. Barnes, 125 F.3d 1287, 1290-91 (9th Cir. 1997):** discussed in detail below, where district court's use of gross revenues was rejected in case involving receipts by medical clinic for apparently competent services rendered by defendant who impersonated a doctor.
 5. **U.S. v. Maurello, 76 F.3d 1304, 1311-1313 (3d Cir.1996):** discussed in detail below, where the court rejected the government's argument that the loss in a case where a disbarred attorney continued to render legal services to clients, should be the total amount billed.
- C. **U.S. v. Burridge, 191 F.3d 1297, 1301 (10th Cir. 1999)**
1. **Held:** monies recovered by fraud victims through separate civil actions will not be offset against loss calculation. Reason: "that money was not returned through (defendant's) voluntary actions, but rather through action by the victims subsequent to the discovery of the fraud." (Opinion at 1301)
 2. **Accord:** U.S. v. Janusz, 135 F.3d 1319, 1324 (10th Cir.1998) (no offset where fraud victims recovered some of their lost money by acquiring defendant's frozen assets).
- D. **U.S. v. Barnes, 125 F.3d 1287, 1290-91 (9th Cir. 1997)**
1. **Important case which is factually similar to, and which discusses at length, the Third Circuit's opinion in U.S. v. Maurello, 76 F.3d 1304, 1311-1313 (3rd Cir. 1996), discussed below.**
 2. **Facts:** defendant impersonated a doctor and examined / treated numerous patients. The primary clinic for which he worked, Bio-Medics, received gross revenues of between \$3-5 million for defendant's services.
 3. **District Court:** applied the "rescission theory" of loss by which "the court calculated the amount necessary to refund the total charges billed by Appellant's employers for all patients Appellant treated or examined." (Opinion at 1290)
 4. **Circuit:** rejected this approach, noting that "[t]he court, however, ignored any benefit which Appellant may have provided to the clinics." (Opinion at 1290)
 - a. The Circuit essentially concluded that this was a zero loss case because the employer at Bio-Medics did not sustain any actual loss from the crime of impersonating a physician. The following excerpt highlights the key facts:

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Because the loss caused by Appellant's employment at Bio-Medics presents the only real issue, we will concentrate on that calculation. From October 1991 through June 1994, Appellant worked part-time at the Bio-Medics plasma center, which sells donated plasma to third parties. During his employment, Appellant performed physical examinations on potential blood donors and reviewed and signed quarterly lab reports containing the results of tests performed on the donated plasma. The government estimated that Appellant's work accounted for \$4,214,655 of the center's gross revenues during his tenure. Appellant received \$181,989 in total wages for this work. It is important to note that no Bio-Medics customers demanded a refund for monies paid for plasma donated by people examined by the Appellant. In addition, the clinic billed neither the plasma donors nor their insurance companies for the physical examination or the blood tests performed by Appellant or any other employee. Apparently, Appellant's fraudulent actions resulted in no harm to either patients or plasma customers. In short, absent his total salary, Appellant's fraud imposed no monetary loss upon the clinic, donors, or customers. [Opinion at 1290]

- b. *Key Point:* In remanding for resentencing, Circuit left open the possibility that an upward departure might be appropriate because the actual loss figure (zero) under-represented the harmfulness of the conduct, per Application Note 11 to 2F1.1. [Opinion at 1291].

E. U.S. v. Maurello, 76 F.3d 1304, 1311-1313 (3d Cir.1996)

1. Facts: disbarred attorney continued to render legal services to clients. He billed for the services and received payment.
2. Circuit: rejected government's argument that loss should be based on the total amount billed / collected by the disbarred attorney from the clients. Instead, Circuit focused on the value of the services rendered by attorney, recognizing that the clients received a benefit even if the defendant was not authorized to practice law.
 - a. To determine the amount of loss, the court remanded the case to the district court to ascertain which of the dissatisfied clients' complaints were legitimate and the total loss attributable to those complaints. It cautioned, however, that "[t]o the extent that the unauthorized services provided by defendant have not harmed their recipients, but to the contrary have benefitted them, we conclude that defendant's base offense level should not be enhanced." (Opinion at 1312-1313, discussed in U.S.

v. Barnes, supra, 125 F.3d at 1290-91).

- b. **Key Point:** In remanding for resentencing, Circuit left open the possibility that an upward departure might be appropriate because the actual loss figure (zero) under-represented the harmfulness of the conduct, per Application Note 11 to 2F1.1. (Opinion at 1313). The same approach was taken by the Ninth Circuit in Barnes, supra 125 F.3d at 1291.

F. U.S. v. Sublett, 124 F.3d 693 (5th Cir. 1997)

1. Read this case in conjunction with Barnes and Maurello. Sublett was convicted of mail fraud and contractor fraud under 18 U.S.C. 494.
2. **Facts:** Sublett owned a company that marketed counseling services. “He misrepresented his academic and professional qualifications in his bid to win a five-year contract to provide counseling services to Internal Revenue Service employees in Austin, Texas. When he applied for a second contract with the IRS in 1994, he again misrepresented his credentials. He also submitted falsified diplomas and certifications to the IRS. Under the first contract the IRS paid his company \$166,323.44. Sublett provided qualified counselors for most of the sessions; however, Sublett, who was not qualified, personally provided some counseling and also billed the IRS for sessions that never occurred. Sublett’s scheme was uncovered before he began to perform the second contract under which his company was to receive payments totaling \$212,016.” (Opinion at 694)
3. **District Court:** “adopted the presentence report’s computation that the total loss caused by Sublett was equal to the total amount paid under the first contract plus the total amount to be paid under the second contract.” (Opinion at 694)
4. **Circuit:** vacates and remands for resentencing, finding that despite the fraud regarding defendant’s credentials, the counseling services may still have conferred a value on the U.S. “The district court therefore must deduct the value of the legitimate services actually provided by Sublett’s operation under the first contract and those that he intended to provide under the second contract in its calculation of the loss under section 2F1.1.” (Opinion at 694)

G. U.S. v. Burns, 104 F.3d 529, 535-536 (2d Cir. 1997)

1. Supports proposition that district court has flexibility in adopting a formula or method by which to determine the dollar amount to offset against the loss figure, to account for the value of services performed by defendant. This determination

will be reviewed under a clearly erroneous standard. (Opinion at 535-536)

2. **Facts:** Defendant was a program manager on a federally funded project which required him to work full-time on behalf of the company, located in Vermont, which was under contract with the U.S. government. He proceeded to enroll full-time at Harvard and lease an apartment in Boston which he paid for with funds from the federal project, while submitting time sheets for salary which purportedly demonstrated that he was working full time as program manager. He was indicted for mail fraud and making false statements to a federal agency.
3. **Circuit:** the key issue under 2F1.1 was the lost salary which had been paid to defendant while he was attending Harvard full time. The Circuit upheld the district court's (1) conclusion that defendant had provided some work on the project and that he was therefore entitled to a certain offset against the lost salary figure; (2) formula for determining an offset figure. (Opinion at 536)

H. U.S. v. Sayakhom, 186 F.3d 928 (9th Cir. 1999), *amended* 1999 WL 1076215 (1999)

1. Affirms sentence, rejecting offset in fraud case involving operation of unlicensed insurance company. Useful analysis on the issue of offset.
 - a. Rejects defendant's contention that the value of money lawfully received as membership or deposit fees should have been excluded from loss calculation.
2. Opinion recognizes that "value may be rendered even amid fraudulent conduct," and that in calculating loss, the district court should give credit for any legitimate services rendered to the victims. See, U.S. v. Blitz, 151 F.3d 1002, 1012 (9th Cir. 1998).
3. However, if the value to the victim is merely part of the fraudulent scheme, the defendant is not entitled to credit.
4. In this case, the district court properly declined to offset loss by crediting defendant with any of the expenses of operating her insurance company because the company was "permeated with fraud."

I. U.S. v. Fiorillo, 186 F.3d 1136 (9th Cir. 1999)

1. Reverses district court's refusal to grant offset in environmental case.
2. **Facts:** eleven truckloads of hazardous waste were delivered to defendants for disposal, and they were paid a total of \$254,000 for disposal.

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3. **District Court**: found that the contract for the disposal was fraudulent from its formation; therefore, the intended loss was the entire amount under the contract.
 4. **Circuit**: reverses for the defendant. Because two of the eleven shipments were properly disposed of, there was no loss as to these two loads.
 - a. The loss calculation therefore should have reduced: offset granted.
- J. **U.S. v. Cooper**, 173 F.3d 1192 (9th Cir. 1999): offset theory applied *against* defendant
1. Defendant convicted of mail fraud and environmental violations.
 2. **Facts**: City of San Diego hired defendant's company to transport sewage sludge and compost to a specific location in California and paid the company \$566,000. Instead, defendant transported the materials to another part of California and spread it on farmland.
 3. Over defense objection, District Court calculated intended loss at \$566,000. Defendant argued that City lost no money and in fact received a value by having the sewage/compost hauled away. District Court focused on intended loss.
 4. **Circuit affirms**: any value to the City from hauling away the sewage/compost was *offset* by the harm caused by the company's failure to legally dispose of the materials per the contract with the City. Defendant's action exposed the City to cleanup liability.
- K. **U.S. v. Swanquist**, 161 F.3d 1064 (7th Cir. 1998)
1. Defendant convicted of making false statements to financial institutions.
 2. District Court bases loss calculation on date the government discovered the fraud. Defendant had argued the calculation should be based on the date the lenders discovered the fraud, which would have made the loss zero because all of the outstanding loans had been repaid by the time the lenders learned of his actions.
 3. **Circuit affirmed**: upheld proposition that an offense is discovered for loss calculation purposes when the victim or the proper authorities discover the fraud, whichever comes first.
 - a. After discovery has occurred, money subsequently repaid on fraudulently procured loans may not be set-off against the amount of

loss.

L. U.S. v. Parsons, 141 F.3d 386 (1st Cir. 1998)

1. Parallel civil and criminal proceedings: deals with the issue of whether a settlement with a federal agency in the parallel civil action can serve as an offset against loss in the criminal fraud case.
2. Facts: Defendant convicted of conspiracy to commit bank fraud in connection with fraudulent procurement of a loan. He argued that the loss under 2F1.1 should be zero because in the parallel civil action, the bank's receiver, the FDIC, had reached a civil settlement with him.
3. Circuit: rejects defendant's argument, holding that the civil settlement did not reduce the loss.
4. Reason: "Loss is a proxy for the seriousness of the offense. A loss of zero is presumptively wrong in this case, since it does not even remotely approximate Parsons's wrongdoing." (Page 392).
5. Cf. U.S. v. Gallegos, 975 F.2d 710, 713 (10th Cir. 1992)(holding that settlement agreement between defendant and bank, whereby defendant foregoes pursuing counterclaims against bank in related civil action, acts as offset against 2F1.1 loss); U.S. v. O'Connor, 166 F.3d 344 (9th Cir. 1998)(distinguishing Gallegos)

VII. Offsets Against Loss For Repayments To Victims

- A. General Rule: An offset against loss may be allowed under 2F1.1 for repayments to the victim(s) that occurred *prior to* detection of a fraud – i.e., “pre-detection paybacks.” On the other hand, repayments that occur *after* the fraud has been detected – “post-detection paybacks” – do not warrant an offset against loss. However, both types of repayments do justify offsets against restitution.
1. Strategic Pointer: it is particularly important to keep in mind the distinction between an offset against loss based on a benefit conferred on the victim, and an offset based on repayments to the victim during the time period in which the fraud is being perpetrated. In the latter case, courts routinely deny any offset, frequently citing the proposition that repayments to victims during the course of the fraud is often necessary in order for the scheme to continue.

- B. U.S. v. Stoddard, 150 F.3d 1140 (9th Cir. 1998)**
- 1. Key case, applying the offset theory in the 9th Circuit previously set forth in U.S. v. Allison, 86 F.3d 940, 943 (9th Cir. 1996).**
 - 2. Facts: defendant misappropriated bank funds from escrow accounts. When bank officer inquired about the missing money, defendant repaid it with interest.**
 - 3. District Court: included the full amount of the misappropriation in the loss calculation. Defendant had argued no loss due to full repayment w/interest.**
 - 4. Circuit affirms:**
 - a. States that Allison “only applies to amounts repaid by defendant to the victim prior to discovery of the offense. Repayments do not apply to actual loss if they are made after discovery of the offense but prior to indictment.”**
 - b. Rationale for this rule: “Repayments before detection show an untainted intent to reduce any loss.” On the other hand, “[r]epayments after detection may show no more than an effort to reduce accountability.”**

C. U.S. v. Corace, 146 F.3d 51 (2d Cir. 1998)

1. Important case in demonstrating that in theft cases (as compared to fraud cases), repayment by defendant may result in no offset, even if made prior to detection.
2. **Facts:** Defendant was president, sole shareholder and pension plan trustee of a company. He misappropriated funds withheld from employees' payroll checks for the pension plan, and used them to pay company's operating expenses. He recorded in company books a current liability to the pension plan. He later sold the company's assets. Rather than replenish the misused pension plan funds, the purchaser transferred 1.5 million shares of its common stock.
3. **Circuit:** defendant not entitled to any offset against loss for the value of the stock, even if it were held to repay the pension plan.
4. **Reason:** "For purposes of a sentencing loss calculation, a thief or an embezzler has no right to claim an offset for the value of monies returned to the victim between the initial wrongdoing and the time of detection." (Page 55)

D. U.S. v. Janusz, 135 F.3d 1319 (10th Cir. 1998)

1. Important case in highlighting proposition that a defendant cannot expect an offset against loss simply because the victims happen to recover some of their losses after the fraud was detected. (Note that this case involves the issue of offset in a context other than repayment by a defendant to the victim.)
2. **Facts:** Defendant, a private financial consultant, loaned to third parties and transferred to his own account large sums of money belonging to a client. Convicted of wire fraud.
3. **District Court:** found the loss was \$1,556,600, calculated as follows: \$2,263,000 as the total misappropriated funds deposited into accounts under defendant's control; *minus* \$776,000 which defendant spent during the time period of the fraud on authorized expenses of the clients; plus \$80,000, which defendant unsuccessfully tried to take from a client fund after the fraud was reported. Thus, District Court allowed offset for payments made to victims during the course of the fraud, but not after detection.
4. Defendant argued for an offset of \$250,000, which the clients recovered from one of the defendant's accounts after it was frozen, and the amounts the client ultimately recovered from third party borrowers after defendant's crimes were discovered.

5. **Circuit affirms:** “. . . the purpose of the loss calculation under the Sentencing Guidelines is to measure the magnitude of the crime at the time it was committed. The fact that the victims have been able to recover part of their loss after the discovery of the fraud does not diminish Mr. Janusz's culpability and responsibility for purposes of sentencing.” (Page 1324)
 6. Circuit acknowledged prior 10th Circuit ruling in U.S. v. Gennuso, 967 F.2d 1460, 1462 (10th Cir. 1992), that loss is to be calculated as the "net value, not the gross value, of what was taken."
 - a. Distinguishes Gennuso by stating that “The net loss rule of Gennuso and other cases merely requires the court to deduct from the loss calculation any value the defendant gave the victim at the time of the fraud. Here the court properly deducted the amount Mr. Janusz spent, during the scheme to defraud, on his victims' legitimate expenses.” (Page 1324)
- E. U.S. v. Bald, 132 F.3d 1414 (11th Cir. 1998)
1. **Facts:** defendant used her employer's credit cards to make unauthorized purchases exceeding \$500,000. Some items were returned prior to detection.
 2. **Circuit:** Refused to grant offset by the amount of the returned merchandise, holding that all charges on the cards should be included in the loss calculation.
 - a. Court applied 2B1.1 on the ground that, although the cards were not stolen, misuse of a credit card entrusted to one's care is analogous to theft. By this analysis, the loss is determined as of the moment of purchase.
- F. Repayments In Check Kiting Schemes
1. **General Rule:** “The amount of actual loss is determined at the time the check kiting scheme is discovered, not at the time of sentencing, meaning that restitution made after the discovery does not offset the total amount of loss.” U.S. v. Whitehead, 176 F.3d 1030, 1042 (8th Cir. 1999)

2. Other cases:

- a. U.S. v. Akbani, 151 F.3d 774, 778 (8th Cir.1998);
- b. U.S. v. Flowers, 55 F.3d 218, 221-22 (6th Cir.1995) (" 'The fact that a check kiter enters into a repayment scheme after the loss has been discovered does not change the fact of the loss' ") [quoting U.S. v. Mau, 45 F.3d 212, 216 (7th Cir.1995)].

G. Additional Cases To Note:

1. U.S. v. Carrozzella, 105 F.3d 796, 805 (2d Cir. 1997) (“We have held that loss in fraud cases includes the amount of property taken, even if all or part has been returned.”);
2. U.S. v. Mucciante, 21 F.3d 1228, 1237 (2d Cir. 1994) [offset denied where repayment was deemed a “meretricious effort to maintain (victims’) confidences.];
3. U.S. v. Dobish, 102 F.3d 760, 762 (6th Cir. 1996) (“The court also found that money was returned only as a means of perpetuating the fraud, and that the scheme would have been continued indefinitely had the victims not discovered what was going on. We cannot say that these findings were clearly erroneous, and we accept them as justification for the district court's loss calculation.”)

VIII. Intended Loss: Doctrine Of Impossibility

- A. U.S. v. Ensminger, 174 F.3d 1143 (10th Cir. 1999): where a fraud has no possibility of success, district court may not sentence on the basis of the intended loss.
 1. Cites U.S. v. Galbraith, 20 F.3d 1054 (10th Cir. 1994): “the loss the defendant subjectively intended to cause is not controlling if he was incapable of inflicting that loss.”
 2. Note: several other circuits have disagreed with *Galbraith*’s analysis of intended loss.

- B. U.S. v. Watkins, 994 F.2d 1192, 1196 (6th Cir. 1993): a key case for the defense: held that loss must not only be intended but also possible of infliction.
 - 1. But Watkins has been rejected by both the 7th and 9th Circuits:
 - a. U.S. v. Blitz, 151 F.3d 1002 (9th Cir. 1998)(telemarketing)
 - b. U.S. v. Yusufu, 63 F.3d 505, 513-14 (7th Cir. 1995)
- C. U.S. v. Stockheimer, 157 F.3d 1082 (7th Cir. 1998): affirms district court, but indicates that the improbability of the intended loss may be a basis for a downward departure.
 - 1. In this case, the district court had found that the defendants intended to cause a loss of over \$80 millions, which the Circuit said might seriously overstate the seriousness of the defendants' offenses.

IX. Whether To Include Interest In the Loss Calculation

- A. U.S.S.G. 2F1.1, Application Note 8 (1999 ed.), states in part:
 - 1. The commentary, as amended, states: "As in theft cases, loss is the value of the money, property or services unlawfully taken; it does not, for example, include interest the victim could have earned on such funds had the offense not occurred."
 - 2. This language is an amendment that went into effect on November 1, 1992 by which interest was expressly excluded from the calculation of loss.
- B. The Distinction Between Bargained-For Interest And Opportunity-Cost Interest
 - 1. Explaining the distinction:
 - a. U.S. v. Allender, 62 F.3d 909, 917 (7th Cir.1995), *cert. denied*, 516 U.S. 1076 (1996): interprets the commentary's reference to "interest" as referring "to speculative 'opportunity cost' interest--the time value of money stolen from the victims," and not to "a guaranteed, specific rate of return that a defendant contracts or promises to pay."
 - (1) Allender is an important case in establishing the framework for the analysis as to the applicability of interest in the loss

calculation. See, U.S. v. Porter, 145 F.3d 897, 900 (7th Cir. 1998).

2. U.S. v. Sharma, 190 F.3d 220, 227 (3rd Cir. 1999): the excerpt below discusses this key distinction and establishes the position of the Third Circuit that, despite the Nov. 1992 amendment excluding interest, 2F1.1 excludes only opportunity-cost, but not bargained-for, interest from the loss calculation:

“Application Note 8, as amended, which states that the valuation of loss does not “include the interest the victim could have earned,” concerns fraud cases, in which interest typically reflects only opportunity cost. The plain language of the application note suggests that the Sentencing Commission intended to distinguish bargained-for interest from opportunity-cost interest. The application note excludes from the calculation of loss “interest the victim could have earned.” U.S.S.G. § 2F1.1, Application Note 8 (emphasis added). Opportunity-cost interest is interest the victim could have earned. In contrast, bargained-for interest is an integral part of the borrower's obligation to the lender. Such interest is an important, enforceable aspect of the contractual agreement and reasonably included in the calculation of the bank's loan. If the Sentencing Commission had intended to exclude bargained for interest from the loss calculation, it could have used appropriate language when drafting the note. Allender, 62 F.3d at 917.

“There is a definitive distinction between interest a debtor is contractually required to pay the victim (i.e., bargained for interest) and interest a victim could have earned had it invested the money that had been lost as a result of the defendant's misconduct (i.e., opportunity-cost interest). See *id.* (holding interest on loan is not opportunity cost and includable in calculation of loss); *United States v. Goodchild*, 25 F.3d 55, 65-66 (1st Cir.1994) (same); *Lowder*, 5 F.3d at 467 (same). The former is a specifically defined obligation; the latter is speculative. See Allender, 62 F.3d at 917. A creditor has a reasonable expectation to receive the interest on the loan. See *Henderson*, 19 F.3d at 928. After the loan agreement is signed, both the principal and the obligatory interest become the creditor's property. See Allender, 62 F.3d at 917. Interest-bearing loans, especially mortgage and equipment loans, are an important part of a large secondary loan market in this country. We read Application Note 8 as requiring the exclusion of opportunity-cost interest, but not bargained-for interest, from the valuation of the victim's actual loss.”

- C. Prior to Sharma, several other circuits had also held that, despite the Nov. 1992 amendment to Application Note 8, bargained-for interest due on a loan should be included in the calculation of loss:
1. U.S. v. Nolan, 136 F.3d 265, 273 (2d Cir.), *cert. denied*, 524 U.S. 920 (1998) (amount taken under section 2F1.1 includes both principal and unpaid interest and penalties on a note);
 2. U.S. v. Gilberg, 75 F.3d 15, 19 (1st Cir.1996);
 3. U.S. v. Goodchild, 25 F.3d 55, 66 (1st Cir.1994) (finance charges and late fees due as a result of fraudulent use of credit cards included in loss);
 4. U.S. v. Allender, 62 F.3d 909, 917 (7th Cir.1995) ("the value of the thing taken" includes both the principal of a fraudulently-procured loan as well as agreed-upon interest.);
 5. U.S. v. Jones, 933 F.2d 353, 354-55 (6th Cir. 1991);
 6. U.S. v. Henderson, 19 F.3d 917, 928-29 (5th Cir.), *cert. denied*, 513 U.S. 877 (1994) (interest on fraudulently procured loan can be included as part of loss if there is a reasonable expectation of receiving that interest);
 7. *cf.*, U.S. v. Allen, 88 F.3d 765, 771 (9th Cir.1996) (implying interest can be included in calculation of loss).
 8. *But See*, U.S. v. Hoyle, 33 F.3d 415, 419 (4th Cir.1994) (holding interest not includable in loss calculation).
- D. However, not all circuits have adopted the distinction between opportunity-cost and bargained-for interest. *See*, U.S. v. Guthrie, 144 F.3d 1006, 1011 (6th Cir. 1998) (adheres to literal interpretation of Application Note 8 whereby interest is not to be included in loss calculation; but district court's inclusion of interest in the case was harmless error because omission of interest resulted in same sentence).
- E. *Strategic Pointer*: Defense counsel must assess whether the client, in an effort to disguise the fraud a while longer, misrepresented to the victims that their investments had appreciated over time, or that they had accrued a certain amount of interest, thus increasing the total of their investments. Under these circumstances, the defendant has promised a certain rate of return as part of the fraud. Courts are therefore likely to include interest in the loss calculation by treating the misrepresentations as "bargained-

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for” interest. U.S. v. Porter, 145 F.3d 897, 900-901 (7th Cir. 1998) [“(T)his case concerns accrued interest or appreciation that the investor was told he had earned. Thus, Jackson would reasonably expect to receive that interest as well as his entire principal upon liquidating the account.”]; U.S. v. Lowder, 5 F.3d 467, 471 (10th Cir.1993) (interest included in loss when defendant promises victims a specific rate of return).

- F. *Strategic Pointer*: defense counsel who practice in the Fourth Circuit should note the following useful language from U.S. v. Parsons, 109 F.3d 1002, 1004 (4th Cir. 1997):

“[L]oss under § 2F1.1(b)(1) is the actual, probable, or intended loss to the victims.” United States v. Marcus, 82 F.3d 606, 608 (4th Cir.1996) (quoting United States v. Chatterji, 46 F.3d 1336, 1340 (4th Cir.1995)). The loss itself (whether the actual or intended loss) is *limited to the tangible economic loss of the victim*. Lost potential interest on improperly taken funds, for example, is not counted as loss.” [emphasis added]

[end of outline]