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Mr. Chairman and members of the Commission,

We are pleased to appear before you today to discuss the proposed amendments to the fraud and theft guidelines. We appreciate the Commission's efforts to address the important area of fraud and theft and to search for ways to improve the guidelines that affect these cases. We also appreciate the parallel efforts to address the tax guidelines. Our comments will focus on the three areas of the Commission's inquiry today: the loss tables, more than minimal planning and sophisticated means as sentencing factors, and finally, the definition of loss.

As an initial matter, we urge the Commission to move ahead to revise the loss tables and, at the same time, enact the changes closely related to that revision. These changes would include amendments regarding more than minimal planning, the sophisticated means enhancement, and the referring guideline amendments. The Commission has received extensive public input on these issues over multiple guideline cycles. These issues are ripe for decision.

In contrast, we are concerned that the loss definition issues are being rushed to decision without sufficient study and public input. As we believe changing the loss definition is not integral to changes in the tables, we caution the Commission to move slowly in its consideration of a wholesale revision to the loss definition. We support the amendment of the tables in this amendment cycle and remain ready and willing to

work with the Commission on the complex definition issue regarding loss in the upcoming year.

LOSS TABLES

Turning to the proposed revision of the fraud and theft loss tables, we applaud the Commission for recognizing the importance of improving the tables that, to a significant extent, control the sentences applicable to a myriad of white collar offenses.

The Commission has proposed two options to amend the loss tables in the fraud and theft guidelines and is also considering a third option developed in April 1997. Recognizing that all of the options improve the current sentencing structure, the Department prefers Option 2 especially in the mid- to high-dollar range, where it increases sentences more quickly for offenses at dollar amounts between $70,000 and $1.2 million. Offenses at these levels are serious and common. The loss amount for approximately one-fourth of the defendants sentenced in fiscal year 1996 under guideline §2F1.1 fell within this range. Option 2 would place an offender who commits a fraud of just over $70,000 at offense level 16 (21-27 months of imprisonment for a first offender or 12-18 months with a three-level reduction for acceptance of responsibility) and one who commits a $1.2 million fraud at level 22

(41-51 months or 30-37 months with a three-level reduction for acceptance), with graduated increases between.

By contrast, Options 1 and 3 rise more slowly for offenders in the $70,000 to $1.2 million range. For example, both of these options would place a defendant whose offense involved just over $70,000 at offense level 14 (15-21 months or even a split sentence with as little as five months of imprisonment after acceptance of responsibility) -- exactly where such an offender is under the current guideline if the offense involved more than minimal planning, as the vast majority do at this level. Similarly, at $1,000,000 Option 2 would result in an offense level of 22 (41-51 months or 30-37 months with a three-level reduction for acceptance), while Options 1 and 3 would produce offense level 20 (33-41 months or 24-30 months with a three-level reduction for acceptance), just one level above the current level with more than minimal planning.

To deter serious offenses in the range of $70,000 to $1.2 million, improvement in the fraud and theft loss tables is needed. All three options recognize this need where larger dollar amounts are involved: at amounts of $1.2 million and greater, all three options are the same and reflect significant increases over current sentences. We applaud the Commission in recognizing the seriousness of these extensive offenses and

urge the Commission to acknowledge the need for increases in the mid- to high range discussed.

MORE THAN MINIMAL PLANNING AND SOPHISTICATED MEANS

We support the deletion of the enhancement for more than minimal planning or a scheme to defraud more than one victim. We view the deletion of these factors and their incorporation into the loss tables as a positive step in reducing litigation. However, the goal of reduced litigation will not be realized if courts are permitted to reduce sentences based on minimal planning.

We strongly oppose the addition of language providing a reduction in the offense level because of "limited or insignificant planning" or "simple efforts at concealment," as proposed. The table does not incorporate more than minimal planning at all offense levels; therefore no basis at all exists for a reduction at lower dollar amounts. More importantly, however, if minimal planning is allowed or not prohibited as a basis for departure, defendants will likely argue it as a matter of course. The result will be that minimal planning will become a frequent litigation issue, just as more than minimal planning has been a litigation issue under the current guidelines, and uneven results will be likely. The net effect will simply be to shift the burden from the prosecution to the defense, without eliminating the factor from consideration.

A balanced approach would be for the Commission to adopt language prohibiting a downward departure on the basis of minimal planning and upward departure on the basis of more than minimal planning, as presented by the Commission in an issue for comment. The promulgation of such language would signal to all parties that the Commission has adequately taken into account the issue of minimal planning and more than minimal planning, as reflected in the loss tables for fraud and theft. If, on the other hand the Commission remained silent on the departure issue, that silence will likely result in litigation as defendants and prosecutors seek to test the views of the courts of appeals on minimal planning as a basis for downward departure and more than minimal planning as a basis for upward departure. This is an issue the Commission can decide before a circuit conflict develops.

The Commission has also proposed a specific offense characteristic providing a two-level increase for sophisticated concealment or for either sophisticated concealment or commission of the offense from outside the United States. An enhancement for sophisticated means used to impede the discovery of the existence or extent of the offense currently is found in the tax evasion guideline, §2T1.1(b)(2). The proposed new factor for the fraud and theft guidelines would expand an existing specific offense characteristic in the fraud guideline, which provides a floor of offense level 12 if an offense "involved the use of foreign bank accounts or transactions to

conceal the true nature or extent of the fraudulent conduct." USSG §2F1.1(b)(5). The proposed enhancement would broaden this concept to apply to other means besides the use of foreign bank accounts or transactions aimed at concealing the fraudulent conduct and would provide for a two-level enhancement above level 12 as well.

Two options are presented. We prefer the one that specifically provides for the commission of the offense from outside the United States. We also recommend that the proposed specific offense characteristic for theft and fraud be as close to the tax provision on this issue as possible so that the existing body of case law on the current tax guideline can apply to the proposed addition of this factor to the theft and fraud guidelines.

LOSS DEFINITION

We understand that the purpose of revising the loss definition is to simplify the fraud and theft guidelines, to reduce litigation, and to reflect better the seriousness of the offense and the culpability of the offender. We appreciate the Commission's efforts at simplification. We also appreciate that the proposed loss definition expands coverage in a significant way that we regard as a positive step by the Commission. The current commentary to the guidelines limits consequential damages to two classes of offenses -- defense procurement fraud and product substitution cases. USSG

§2F1.1, comment. (n.7(c)). By contrast, the proposed definition is not so limited and includes reasonably foreseeable harm resulting from any fraud or theft offense. This broader approach should provide a more accurate view of the seriousness of the offense in many cases.

Nonetheless, we fear that the proposed definition, rather than reducing the amount of litigation, may have precisely the opposite effect and that practically every detail of the loss definition will involve new issues for the courts. Unlike the tables, as to which the Commission has received substantial and detailed public comment, the loss definition should be the subject of more time and study before it is entirely rewritten by the Commission. However, if the Commission is intent upon amending the definition of loss this amendment cycle, we would like to work with the Commission to address several significant issues, including the treatment of gain, credits against loss, and departures.

Gain. As to gain, we believe that it can be a useful tool in determining the seriousness of an offense and can serve as a proxy for loss in cases where the extent or risk of loss cannot readily be shown. Such cases would include, for example, food and drug offenses and other crimes that violate a regulatory scheme. Actual loss may be little in such cases, but the risk of severe harms and thereby loss may be great --

which is why the regulatory scheme exists. The gain produced by the offense is one means of measuring the extent of the offense and the defendant's culpability.

Ensuring that gain may be used as the measure of harm when it is greater than the reasonably calculable loss would be consistent with the treatment of gain in the organizational guidelines, where the fine is based on the greatest of the amount from the relevant table, the pecuniary gain to the organization from the offense, or the pecuniary loss from the offense to the extent it was caused intentionally, knowingly, or recklessly. USSG §8C2.4. To assure that the loss definition guarantees the use of gain as a measure of the harm in appropriate cases, we urge the Commission to include gain in the general rule in Note 2(A), rather than in the provisions on the determination of loss in Note 2(B). As proposed, Note 2(B) treats gain as one of six factors the court is directed to use in making a reasonable estimate of the amount of the loss. This provision may be subject to arguments that it provides a measure of flexibility that would allow the sentencing judge to ignore gain, even where it is shown to be greater than loss. Alternatively, the Commission could amend the introductory portion of Note 2(B) to impose a hierarchy in applying the various formulations of loss that would clarify when gain and other factors are to be used as the basis for determining loss in cases where several factors might apply.

We are also concerned that the Commission's proposed treatment of gain may inadvertently result in the use of gain to limit the measure of harm. Proposed Note 2(B)(vi) sets forth the following provision defining gain as a factor to be used in the determination of loss: "The gain to the defendant and other persons for whose conduct the defendant is accountable under §1B1.3, if gain is greater than loss or if loss is difficult or impossible to determine." Under this provision defendants may argue in a case in which loss is difficult to prove that the court should rely on gain as a measure of the harm caused by the offense, despite the fact that the government is prepared to show a greater loss. We do not believe the Commission intends this result. Therefore, proposed Note 2(B)(vi) should be amended to limit the use of gain in cases where loss is difficult or impossible to determine to situations where loss as measured is likely to underestimate the harm from the offense.

Credits Against Loss. Another concern we have with the proposed loss definition relates to the issue of computing credits against loss. Proposed Note 2(C) would instruct the court in determining the amount of loss to "credit an amount equal to the value of the economic benefit the defendant transferred to the victim before the defendant knew or had reason to believe that the offense had been detected." This provision will likely result in litigation in every case. Issues will be raised as to whether the defendant provided an economic benefit, the value of the benefit, and the timing of the defendant's action. While the current rule recognizes credits in certain

types of cases, such as product substitution, the proposed rule makes the credit theory potentially applicable to all frauds and thefts. For example, telemarketers often provide trinkets to their victims to lure them into telemarketing schemes. The items provided have no real value relative to what the victim paid, but the proposed rule will create litigation regarding the value of such items as grocery store coupons and phony Rolex watches.

The proposed credits rule fails to reflect that some items or services may carry no economic benefit to the victim even though there may be some intrinsic market value. For example, in a product substitution case involving orange sugar water sold as orange juice, the water carries no value when labeled as orange juice. Yet under the proposed rule, as well as the current commentary on product substitution, USSG §2F1.1, comment. (n.7(a)), defendants will argue that there is value to the sugar water sold as orange juice. This problem might be rectified by the addition of language at the end of the second paragraph of proposed Note 2(C) such as: "The 'economic benefit' should be considered in light of the victim's intended transaction and may be zero even though some economic benefit would have been present in the absence of a fraud or theft."

The proposed credits rule also presents a problem with regard to property pledged or otherwise provided as collateral. The proposed rule states that the value of

the economic benefit is its fair market value as of the time the defendant transferred it to the victim, except that value of pledged or otherwise provided collateral is the amount that has been recovered as of the time of sentencing or its fair market value if it has not been disposed of by the time of sentencing. This exception for collateral works well when property decreases in value and a bank that was the victim of a fraudulent loan application recovers only a portion of the amount originally pledged. However, where the value of the collateral stays the same or increases, the credit will eliminate loss, and the fraud will result in an offense level of six, regardless of whether the defendant placed the bank at risk with respect to a $50,000 loan or a $5 million loan. We recommend that the Commission include language, such as that presently found in Note 7(b), recognizing that in such a case the loss may understate the seriousness of the offense.

Departures. Our final major concern with the loss definition is the section on downward departure considerations in proposed Note 2(G). The proposed bases for downward departure are overly broad and are not limited to factors that signify an unusual case. For example, the first -- the fact that a primary objective of the offense was a mitigating, non-monetary objective -- is likely to arise in every prosecution of a corporate executive, who will claim that his or her actions were motivated not by personal greed but by a desire to keep the company afloat and to retain jobs for employees.

The three following downward departure considerations all reflect a troubling inconsistency with the general rules on loss and credits against loss. The first of these -- that the offense was committed in such an inept manner that no reasonable likelihood existed that any harm could have occurred -- is at best questionable where reasonably foreseeable harm in fact occurs. In any case, it seems to run counter to the notion that loss should be measured by the reasonably foreseeable harm resulting from the offense, or the intended harm "even if the harm intended to be caused would have been unlikely or impossible to accomplish ..." as set forth in proposed Note 2(A).

The next downward departure consideration is inconsistent with the general rules set forth on credits against loss. It suggests the appropriateness of a downward departure where the defendant made complete, or substantially complete, restitution prior to the detection of the offense. However, the provisions on credits against loss address this factor and reduce the amount of loss by the credit. This inconsistency suggests the Commission needs to review further when credits should be handled in the calculation of the loss amount and when they should serve as a ground for departure.

The last downward departure consideration is also inconsistent with the general rule set forth on the definition of loss. It provides for the appropriateness of a

downward departure where the loss was substantially increased by an improbable, intervening cause. However, if such a cause were reasonably foreseeable, the general rule would provide for the inclusion of losses so caused. Thus, the very factors that determine the definition are made bases for departure.

Additional Issues. We have several other concerns with the proposed loss definition that we would also urge the Commission to address. We prefer Option 2 regarding interest to Option 1 on opportunity costs and interest. Agreed-upon interest should be provided for in the guidelines, not a provision on upward departure, since the latter will produce uneven consequences for a commonly occurring factor. Some courts will choose to depart upward, while others will not in an identical case. Moreover, even Option 2 may be overly narrow in including only interest that has accrued and is unpaid at the time of sentencing.

We are troubled by the deletion of a special rule from the commentary to existing guideline §2B1.1 regarding protected computers. The current rule indicates that loss includes the reasonable cost to the victim of conducting a damage assessment, restoring the system and data to their condition prior to the offense, and any lost revenue due to interruption of service. Even if the Commission intends for the general definition of loss to cover these items, the deletion of the special rule will likely give rise to arguments that the Commission does not intend such coverage.

Additionally, the proposed loss definition seems to be silent as to attempted and partially completed offenses, although the current guidelines are not. Reliance on "intended loss" may understate the harm that was reasonably foreseeable had the offense been completed in such cases. The failure to address this concern is another indication that more work is needed on the loss definition.

Despite our many concerns, we would like to continue working with the Commission to develop fraud, theft, and tax guidelines that will be workable and that will improve sentences for these offenses.

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PREPARED REMARKS FOR THE UNITED STATES SENTENCING COMMISSION SAN FRANCISCO, CALIFORNIA, MARCH 5, 1998

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Comments on Proposed Changes in the Tax Guidelines

1. **Introduction** -- This panel has been asked to comment on two sets of proposed amendments to the guidelines affecting the sentencing of tax cases. The proposals under Options 1 and 2 in the Proposed Guideline Amendments for Public Comment, and the recently circulated Option 3, essentially seek to raise and harmonize the loss calculations and the consequent sentences resulting under the fraud, theft, and tax guidelines. The Synopsis of Proposed Amendment states that "[t]he purpose of both options [and now presumably all three] is to raise penalties for economic offenses that have medium to high dollar losses in order to achieve better proportionality with the guideline penalties for other offenses of comparable seriousness."

These remarks are my own, but the members of the panel: Justin A.Thornton, Paula M. Junghans, and Charles M. Meadows, Jr. are all practitioners with extensive experience handling the sentencing aspects of tax cases. They have asked me to advise the Commission that, although our reasons may vary, we are in complete harmony in our bottom line recommendations. In this connection, we favor retaining the current tax loss table without regard to whether the fraud and theft loss tables are changed. We also agree that the 12 level increase for low tax loss offenses in both Options 1 and 2 for "sophisticated means" or "sophisticated concealment" should be rejected and that this specific offense characteristic should remain a two level increase at all tax loss levels. I will discuss some of our reasons

for urging these results, and the other panelists will be expressing their views after Mr. Matthews has had an opportunity to offer the Justice Department's view.

Prior to the November 1993 amendments the tax and fraud loss tables were essentially mirror images of each other. In 1993, the Commission severed this relationship at the request of the Justice Department's Tax Division and the Internal Revenue Service. I was one of the Justice Department representatives that appeared before the Commission, endorsing the view that the existing tax table should be adjusted upward to produce higher sentences for tax crimes regardless of what was done with the fraud table. In fact, during that amendment cycle the fraud table was not touched. The Commission nevertheless, adopted the Department of Justice and IRS's view that the tax table needed to be raised, and the existing tax table reflects those increases.

Today, I have the privilege of appearing before a new Chairman and a number of new members of the Commission -- again in support of the 1993 tax table. My 23 years of experience as a practitioner representing both the IRS and taxpayers convinces me that changing the tax table at this time is unnecessary, potentially harmful, and may not achieve "better proportionality" with the penalties for other offenses. As the supervisor of roughly 100 prosecutors in the Tax Division during the years 1989 through part of 1993, I helped compile the Tax Division's annual wish list for submission to this body. In most, if not all, of those years we urged one or another adjustment in the tax guidelines -- sometimes to respond to a troubling court decision and others to address practical problems prosecutors were having in the field -- always seeking change. I believe I was involved in requesting some change -- from minor tightening to a major change in the tax loss table -- in every

amendment cycle I was there. But I did not spend any time considering what change, even well-intentioned, rock-solid, impeccably logical change, does at the in-court, practitioner level where those changes have to be implemented.

One thing I did not foresee in 1993 was that in 1998 different guideline books would still govern the outcome of tax cases sentenced the same year. In fact, the Justice Department is still handling in 1998, and will be handling for the next couple years, cases that involve 1990, 1991, 1992, and conceivably earlier tax returns. Many of those cases will be sentenced using the pre-1993 tax loss table. As a result, the Commission's sentencing statistics are unlikely to reflect much experience using the 1993 tax loss table. Knowing how cases are sentenced under the current table, when all cases are sentenced under that table, would give the Commission better information about whether the tax table needs to be adjusted to make it proportional to the punishments for other offenses. But more significantly, two defendants charged with roughly similar crimes involving roughly similar dollar amounts can be sentenced on the same day under two different tax tables and receive disproportionate sentences. I have come to the firm conclusion that changing fundamental elements of the sentencing of tax offenses creates disproportionality within the sentencing of those offenses over time and creates the appearance of arbitrariness when the same tax offense for different tax years results in vastly different sentences.

Part of this results from skillful charge bargaining by prosecutors and defense counsel but the rest is an unavoidable consequence of the non-retroactivity rule. Today the Commission is being asked to consider and adopt one of three options that would markedly increase guideline levels for taxpayers who commit their offenses on returns filed after

November 1, 1998. Cases involving those returns will start entering the prosecution pipeline three or more years after that. Therefore, sentencing disparities and sharp charge bargaining to avoid the increases in the 1998 tax loss table will unavoidably span at least the next five years. In my view, it trivializes the sentencing guidelines when the length of a defendant's sentence is dependent upon the year the tax crime was committed, and I believe that the arithmetic problems the government will urge on the Commission -- i.e., not a high enough percentage of tax defendants go to prison for a long enough time -- can and ought to be remedied by the IRS's giving the courts more substantial cases and more thorough investigations to sentence.

2. **Are the Sentences in Tax Cases too low?**

a. Attitude of the Sentencing Courts --The A, B, and C ranges of the Sentencing Table provide the courts in the lower ranges of almost all tax offenses the flexibility to adjust the duration and terms of imprisonment to reflect the seriousness of the crime, the need for deterrence, the possibility of recidivism, and steps taken to redress the wrong. Although the Justice Department is unlikely ever to say so, it must either perceive that judges are uniformly biased against prison sentences in the smaller variety of tax cases or that these same judges are uniformly unenlightened as to their power to sentence tax offenses to prison at the upper end of the range. The Justice Department's apparent view is that the current tax guidelines are inadequate, because they do not *compel* courts to sentence low-range tax violators to prison rather than probation, home or community confinement, or some

other alternative to prison.[1]

When the guidelines permit a judge to sentence a tax defendant to probation, the judge, nevertheless, has the authority under the current tax table to sentence the defendant to prison in the upper end of the range. Option 2, favored by the Justice Department, is calculated to narrow the court's discretion to sentence a tax defendant to anything other than a full term of prison only in the most minuscule tax cases -- cases that are too small to meet the IRS's internal guidelines imposing dollar limits for recommending prosecution.

The available statistics reveal an almost uniform rejection by the district courts of prison sentences for low-end of the tax table violators. Part of this may be historic. Pre-guideline tax cases, even very large cases, most often resulted in probation. The original guidelines were intended to send a higher percentage of tax violators to prison, and it appears that they have. But they have done so at a time when the IRS's criminal enforcement program has been in severe decline. In the early 1970's, the IRS's criminal enforcement activities were almost exclusively directed to what were called "general program" cases. The program was focussed on investigating and prosecuting "pure" tax violations, unadorned by non-tax crimes, and on deterring the taxpaying public at large from engaging in tax fraud and

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[1] This view may be a consequence of prosecutors and IRS agents who have become accustomed to handling money laundering, currency, and related offenses and are jaded by the relatively severe prison sentences produced by those guidelines and the leverage they extend to the government. Unless an offense draws a lengthy, virtually mandatory sentence, these agents believe it is not worth investigating. But pandering to this "agents' mind-set" could easily undermine any systematic criminal enforcement of the tax laws, where the IRS cannot show that the reasonable judicial discretion contemplated by the current tax loss table has been harmful, rather than beneficial. It certainly does not justify increasing the tax loss table to shift discretion away from judges to prosecutors and agents in sentencing low-end tax cases.

evasion -- in sum, enforcing the tax laws exclusively. In the late 1970's or early 1980's, the Service began diverting its criminal agents' time away from general program cases to narcotics, organized crime, general white collar crime, and participation in a variety of criminal enforcement "task forces" with FBI and other law enforcement agencies. Today, despite efforts to reverse the trend, relatively few general program cases are developed, and the few that are prosecuted are of considerably lower quality than the cases developed by the IRS in past years.

Despite efforts to rejuvenate the general program by instituting "non-filer" initiatives or by attacking the "tax gap," the fact remains that the Service's criminal tax enforcement program appears to be at a loss for a rationale. This lack of a rationale has resulted in questionable case selection, low quality cases, disproportionate enforcement, and, most troubling of all, investigative short cuts. I have heard these concerns expressed by many tax prosecutors and CID agents and have absolutely no doubt that district court judges, who see the parade of cases produced by the Service today, are making their sentencing decisions in low-end cases based upon these same concerns. The inescapable perception that a low-end tax violator before the court is simply the victim of bad luck, while the IRS's own statistics reveal the existence of vast hordes of worse violators who are not even investigated, cannot give any judge confidence that he or she is doing justice by sending that violator to prison.

Upping the tax table at this juncture in the IRS's history is unlikely to help it restore rationality to its investigative program and may, in fact, be harmful. Tax crimes are different from other theft/fraud-type offenses largely because (1) they generally involve taxpayers' concealing their own income or assets from the IRS rather than affirmatively

taking anything from anybody;[2] (2) the vast majority of tax violators have no other criminal involvement and would never consider engaging in some other form of fraud, theft, or criminal wrongdoing; and (3) statistics show that tax violators -- in spite of the sentences the IRS finds so offensively low -- are extremely rare recidivists. Another practical difference, for the purpose of guideline sentencing, is the extensive role played by relevant conduct in computing tax loss. The guidelines allow the sentencing court to take into account losses in uncharged tax years, tax losses occurring outside the six-year statute of limitation, and the duration of a tax scheme. The IRS virtually always investigates and recommends prosecution of multiple-year cases. As a result, fair and proportionate calculation of tax loss and appropriate sentencing presupposes a thorough investigation of the offense charged and all relevant conduct.

For example, a taxpayer who makes $40,000 per year and is charged with evading $5,500 in one year may not at first blush appear to be an appropriate candidate for prison. But what if a thorough investigation reveals that the same taxpayer's scheme spanned eight years? Without a thorough investigation, the current tax table would initially produce level 8 and permit the court to sentence the taxpayer to probation. But with the benefit of a thorough investigation and all the facts, the court would sentence an eight year tax violator in level 13, facing almost certain prison and no chance for probation even with acceptance of responsibility. An increase in the tax loss table that rewards agents' poor case selection and sloppy or less-than-thorough investigations will do little to help the Service restore its

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[2] False refund cases, although nominally tax cases, are generally prosecuted as violations of 18 U.S.C. §§ 286 or 287 and are sentenced under the fraud guidelines using the fraud loss table in U.S.S.G. § 2F1.1.

enforcement program and risks making the punishment for such offenses less proportional with the severity of the sentences for the remaining handful of thorough investigations, tax offenses of shorter duration, and non-tax offenses generally.

b. Role of Charge and Loss Bargaining -- The Commission's sentencing statistics for tax crimes reveal that a lower percentage of tax violators are sentenced to prison than the Department of Justice believes should be. What these statistics do not show is the extent to which this percentage is skewed by charge and loss bargaining to produce particular sentences. I have already mentioned the problem of incomplete investigations that prevent the sentencing court from knowing the full extent of the defendant's conduct. A related problem stems from the fact that tax offenses are often used to "plead down" more severe non-tax offenses to obtain cooperation or dispose of another type of offense. In task force investigations, tax offenses often appear as statistical add-ons to give the IRS some credit for participating in a joint effort. Today it is the rare case that is investigated and prosecuted as a tax violation without some other criminal involvement. In such cases, dispositions are achieved, not based on what is good for the tax enforcement program or the taxpaying public at large, but to achieve a preordained result for a non-tax purpose.

In addition, courts often see, indeed expect to see, cases in which a defendant is sentenced to an agreed upon tax loss. The process of disputing tax loss at a sentencing hearing is cumbersome and time consuming. As a result, prosecutors and agents agree, with considerable regularity, to present the sentencing court with an agreed-upon tax loss that effectively preordains a non-prison outcome. To the extent that the sentencing statistics reflect this phenomenon, reliance on the statistics to adjust the tax table upward would be

severely misleading and unfair to tax violators who cannot benefit from such agreements.

This poses a particularly troubling problem. We know that the overwhelming majority of tax cases result in pleas and that a large proportion of these are the result of bargains. This is a practical necessity, because tax trials consume disproportionality large amounts of court time. But when we use statistics generated as the result of such plea bargains to assess proportionality with the sentences for other tax offenses and non-tax offenses generally, we are likely to leave those who are unable to bargain with extraordinarily disproportionate sentences. If the Commission's sentencing statistics are at all skewed by charge and loss bargaining, is it reasonable to change the current tax table in the name of achieving some undefined, perhaps undefinable, proportionality?

In fact, raising the tax loss table under either formulation, together with the proposed changes in the "sophisticated means" or "sophisticated concealment" offense characteristics, will increase prosecutors' leverage, and tax defendants' incentive, to obtain more and earlier bargained-for pleas. There is no criminal tax defense lawyer alive who has not been told that if he or she does not plead the client immediately, the tax loss will increase with further investigation and sophisticated means will be added. The proposed increases in the tax loss table will raise the stakes and intensify pressure to work out some kind of early "deal." As a result, the Justice Department and IRS are likely to be back five years from now, after a stretch of rampant charge and loss bargaining, wringing their hands over statistics that continue to show that tax crimes produce too low a percentage of prison sentences or sentences that appear to them disproportionately low.

Perhaps the correct gauge of whether tax sentences are long enough or involve

enough prison would be to consider only cases tried to conviction. In those cases, the courts see the taxpayers' entire crime, and prosecutors have no incentive, and defendants no means, to hold anything back. With nothing more than anecdotal evidence to back me up, I am virtually certain that the percentage of substantial prison sentences in tax cases tried to conviction is extremely high. Of course, this manner of calculation would focus on an inordinately small number of cases. Change is certainly not warranted when we cannot determine with statistics and experience whether the current tax loss table is capable of generating appropriate, proportional results.

c. Will raising the tax loss table deter tax fraud?

In 1993, the primary reason the Tax Division and IRS urged for increasing the tax guidelines was that higher sentences for tax convictions would deter other taxpayers from doing the same. Every year more than 100 million tax returns are filed with the IRS, and IRS projects that each year there is a "tax gap" (an under-reporting and under-paying of taxes actually due) in excess of $100 billion. In enforcing the tax laws the IRS conducts civil audits to collect additional taxes and penalties for about 1% of the returns filed. Less than 1/100th of a percent of all returns are examined for criminal liability. Since it would be impossible to prosecute anywhere near all of the taxpayers who are believed to commit tax crimes, the historical focus of the IRS's criminal enforcement program had been careful, systematic case selection aimed at deterring other taxpayers from committing fraud.

When the IRS and I asked the Commission in 1993 to raise the guidelines to deter tax fraud, I was not asked whether I had any statistical or other support for my contention. I did not, and I suspect that Mr. Matthews still does not. The IRS has tried, but

has not been able to demonstrate persuasively, that the criminal prosecution of one taxpayer has ever resulted in greater tax collections from others. The more difficult, and again unanswerable, question is whether increasing *prison* sentences for the few haphazardly selected tax prosecutions now produced will result in greater collections from other taxpayers. One commentator, Professor Michael Graetz of Yale Law School, has suggested that greater investigative coverage by IRS criminal investigators, rather than the results of the few investigations conducted, would deter more would-be tax violators. In his non-statistical view, systematic investigative presence, not the size of the ultimate penalty creates deterrence. In fact, there is no statistical basis for determining whether the 1993 increase in guideline sentences has had the slightest impact on deterrence.

On the basis of the same intuitive, arithmetic argument we made in 1993, the Department of Justice now asks for a further, even more substantial increase. Perhaps, the argument should run that if we had only asked for and gotten more from the Commission in 1993 the tax gap would now be gone. If deterrence is the standard, we may never know when we have reached the one "right" level for the tax loss table, but increasing the tax loss table in the name of deterrence, without knowing whether the changes are likely to deter anyone from doing anything, hardly seems justified.

3. Sophisticated Means or Sophisticated Concealment?

The Commission is also considering another amendment consisting of two options relating to the "sophisticated means" specific offense characteristic found in several tax guidelines. Contrary to the statistics showing its application in only approximately 16% of all tax cases, experience tells us that this increase is threatened or used in most every tax

case and that very few of the more recent cases are not treated as "sophisticated." The change in definition proposed in Option 2 will probably only lead to litigation. Furthermore, neither Option appears definitively to resolve the question whether individual conduct or offense conduct of others ought to control.

Our primary concern with both of these options is the increase to offense level 12 for tax losses too small otherwise to generate a level 12. Under any of the three proposed tax loss tables, and even under the current table, a $1,000 tax loss accompanied by sophisticated means or sophisticated concealment would generate punishment at level 12 (before acceptance). With the increasing prevalence of this specific offense characteristic in presentence reports, this amendment would generate unduly harsh results for nearly minuscule tax violations. There is no reason to believe that under the current guidelines a judge concerned about particularly egregious concealment conduct by a low-end taxpayer would not sentence the defendant to prison in the upper end of the range or decline to provide an alternative to prison in Zones B or C.

Conclusion

For all these reasons, the members of this panel favor maintaining the *status quo* for tax offenses. The need for increased sentences is, at best, unclear. Indiscriminate raising of sentences relating to low-end taxpayers will not cure long-standing, fundamental defects in IRS's criminal enforcement program and might actually create harmful disincentives to reform. There is no evidence that when presented with a thoroughly investigated tax offense the courts will not use the tools available to them under the current guidelines to sentence appropriately. In sum, there is no reason to believe that the current tax

loss table is inadequate to meet this need or that there is a need to increase it by bolstering the existing "sophisticated means" offense characteristic.

Comments for the United States Sentencing Commission Concerning Proposed Amendments for 1998

I want to thank the Commissioners for allowing the Internal Revenue Service, Criminal Investigation, to appear today. The prosecution and imprisonment of tax offenders is our primary reason for existence, and we are grateful for the opportunity to let you know why it is essential that the sentencing table for tax crimes be reformed as soon as possible. Every year that the Commission delays has the potential to further erode compliance with tax laws, thereby costing the government billions of dollars in lost revenue.

Federal criminal income tax prosecutions are complex, take a long time to investigate, and involve a substantial commitment of time and money from the Internal Revenue Service, the Department of Justice, and the Federal Judiciary. They are also quite rare. Convictions for tax offenses involving legal source income (income unrelated to illegal activities such as narcotics or organized crime) only number approximately 1,500 per year nationwide. Of these, less than 1,000 result in a sentence with true imprisonment.

When one considers that over 115,000,000 individual tax returns are filed per year, and there are millions of illegal non-filers, this situation is clearly intolerable. Tax evaders realize that their chances of being punished for their crimes are minuscule. As a result, honest taxpayers are being forced to pay an ever greater share of the burden. The estimated "tax gap" continues to grow to the point that it now exceeds $100,000,000,000 ($100 billion) per year. Without the effective deterrence of meaningful prison sentences for tax evaders this trend will continue, and the entire system of tax compliance will be in danger of collapse.

We are not asking for unduly harsh or severe sentences. We are asking for sentences that provide a reason for honest taxpayers to remain honest, and for dishonest taxpayers to fear detection. If tax criminals, most of whom are otherwise law-abiding businesspersons, knew that their chances of being prosecuted and imprisoned were greater, compliance would increase proportionately.

Since its inception, the Sentencing Commission has professed to believe that tax evasion is a serious matter. Adopting Option 2 would be a chance to deliver this message in a meaningful way.

3/11/98

The Internal Revenue Service is in favor of any modification to the Federal Sentencing Guidelines which would increase the likelihood that convicted tax criminals would be imprisoned. The deterrent effect for each tax criminal sentenced to imprisonment ranges far beyond the individual sentenced. It extends to the entire surrounding community, the profession, industry, coworkers and business associates of the individual, and in notorious cases, to the entire nation. Conversely, news of tax criminals who are not imprisoned tend to undermine voluntary compliance and weaken enforcement efforts.

The current Sentencing Table does not require imprisonment for offenses in Zone A or B, which includes Offense Levels 1 through 10. Therefore, a minimum Offense Level of 11 must be attained to ensure some incarceration. Since the two level acceptance of responsibility reduction is virtually automatic in all guilty pleas, this means that a Tax Loss in the Offense Level 13 range (Over $40,000 to $70,000) is necessary to be assured of obtaining any imprisonment at all. This tends to exclude all but high income individuals from prosecution.

We must have a balanced enforcement program, which requires that tax evaders from most segments of the income spectrum be prosecuted. If only the wealthiest taxpayers face criminal sanctions, there is no real incentive for the overwhelming majority of the population to comply.

By way of illustration, 96% of all individual returns report adjusted gross incomes of less than $100,000. The average tax on returns with adjusted gross incomes between $75,000 and $100,000 is $12,625. Therefore, for these taxpayers even three years of evading all tax owed would not achieve the $40,000 threshold for 96% of the public.

Therefore, we urge the Sentencing Commission to adopt Option 2 (for revising the Tax Loss Table) contained within Proposed Amendment Number 1, as listed in the January 6, 1998 Federal Register (Vol. 63, No. 3, Part II).

As for Proposed Amendment Number 5(C), concerning "sophisticated means," we agree with raising the base offense level to 12 which is contained in both options. We also are in favor of resolving the circuit conflict so that the element of sophistication is offense specific rather than offender specific, since this goes to the heart of deterrence.

However, we do not see any need to introduce the new terminology of "sophisticated concealment," nor do we approve of the dilution of language relating to the use of foreign bank accounts and financial transactions, and the use of corporate shells and fictitious entities. I believe that these changes will lead only to needless confusion and points of contention. I believe that the existing language is sufficiently clear, especially as it has been interpreted over the ten years that the guidelines have been in existence.

Thank you.

Internal Revenue Service

memorandum

CC:EL:CT
MFKlotz
MAR - 5 1998

date:

to: Assistant Commissioner (Criminal Investigation) CP:CI

from: Assistant Chief Counsel (Criminal Tax) CC:EL:CT

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subject: Proposed 1998 Sentencing Guideline Amendments

The purpose of this memorandum is to apprise you of our views on the 1998 proposed amendments to the sentencing guidelines to the extent they relate to offenses involving taxation. As an overview, we wish to point out our perspective when examining sentencing issues relating to federal criminal tax statutes.

Background

On January 6, 1998, the United States Sentencing Commission set forth six proposed amendments which it may submit to Congress no later than May 1, 1998. The proposed amendments appeared in the Federal Register, (Vol. 63, No.3, Part II) and the United States Sentencing Commission's Proposed Guideline Amendments for Public Comment (January 14, 1998). Written public comment should be received no later than March 12, 1998, by Mr. Michael Courlander, Public Information Specialist, at the United States Sentencing Commission, One Columbus Circle, N.E., Suite 2-500 Washington, D.C. 20002-8002. The Commission has scheduled a public hearing on the proposed amendments for March 12, 1998, at the Thurgood Marshall Federal Judiciary Building, One Columbus Circle, N.E., Washington, D.C. An additional hearing focusing primarily on proposed amendments to the theft, fraud and tax guidelines is scheduled for March 5, 1998, at the Parc Fifty-Five Hotel in San Francisco, California, in conjunction with the American Bar Association's 1998 National Institute on White Collar Crime.

Notwithstanding that the Internal Revenue Service's current philosophy of tax administration focuses on taxpayer education and relies on the compliance of the educated taxpayer, it is, nevertheless, important that there is an adequate sentencing mechanism which effectively addresses noncompliance. Although the Service is continually increasing its efforts to foster taxpayer compliance rather than relying solely on after the fact enforcement, some segments of the population will continue to refuse to comply voluntarily. Accordingly, the focused use of enforcement tools and sanctions

against intentional noncompliance remains essential. To this end, substantial but fair sentencing guidelines permit courts to send the message that tax offenses are serious and intentional violators will be punished seriously. With this concept as our matrix, we offer our comments on the following proposed amendments.

Discussion

Proposed Amendment 1 - Fraud, Theft, and Tax Loss Tables (§§2B1.1, 2F1.1, 2T4.1)

Proposed Amendment 1, *inter alia*, "presents two options for revising the tax loss table to raise penalties for . . . [offenses involving taxation] . . . that have medium to high dollar losses in order to achieve better proportionality with guideline penalties for other offenses of comparable seriousness." Pursuant to Option 1, for tax losses of $40,000 or less, the offense levels of the proposed tax table would remain the same as the current tax loss table. For losses of more than $40,000, the proposed increases in offense levels are the same as the increases in offense levels (two level increments) in the proposed theft and fraud loss tables. Option 2, on the other hand, increases the offense levels in increments of two throughout the proposed tax table.

Considering the two tax table options, Option 2 is our preference. Our preference is based on the fact that, in Option 2, lower tax losses result in higher offense levels than in either Option 1 or the existing tax table, which is consistent with the Commission's intention to treat tax violations as serious crimes. For instance, Zone D (mandatory prison)[1] is reached under Option 2 with a tax loss that exceeds $30,000 while to reach Zone D under Option 1 and the current tax table requires a tax loss in excess of $40,000. Option 2 enables courts to more effectively address a significant area

[1] A sentence falling within Zone D of the Sentencing Table mandates that the minimum term shall be satisfied by a sentence of imprisonment. This would amount to 12 months in jail for an offense level of 13, the first offense level in Zone D.

of noncompliance within the segment of the income spectrum which files the majority of tax returns or fails to file tax returns for any given taxable period.[2]

As we noted above, the tax table in Option 2 incorporates two level increases as opposed to the one level increments in the first part of Option 1 and the present tax loss table, but we do not find this objectionable. In fact, Option 2's tax table seems to provide a somewhat smoother progression through the loss amounts than Option 1's progression from single to double level increments and the current table's single level increments.

Proposed Amendment 5 - Theft, Fraud and Tax Related Issues

Proposed Amendment 5(C), *inter alia*, provides for the modification of the existing sophisticated means enhancement in the tax guidelines and the addition of a "floor" offense level of 12. Once again, two options are presented for comment. Option 1 includes minor non-substantive modifications to the existing sophisticated means specific offense characteristic plus the addition of the "floor" offense level of 12. Option 2, on the other hand, changes the specific offense characteristic from sophisticated means to sophisticated concealment, thus conforming to the proposed language for the fraud and theft guidelines, and also includes the "floor" offense level of 12.

It is our opinion that the important aspect of this proposed amendment is twofold. First, there is the "floor" offense level of 12 which is contained in both options. An offense level of 12 places the offender in Zone C of the Sentencing Table with range of 10 - 16 months imprisonment.[3]

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[2] According to the SOI Bulletin (Fall 1997), for 1995, the average tax on returns in the adjusted gross income range of $75,000 to $100,000 was $12,625. Returns with adjusted gross income of less than $100,000 accounted for approximately 96 percent of all returns filed for 1995. As an unfortunate consequence, under either option the vast majority of taxpayers, even if they are completely noncompliant, would not face mandatory prison.

[3] Zone C of the Sentencing Table provides for a sentence of imprisonment or a sentence of imprisonment that includes a term of supervised release with a condition that substitutes community confinement or home detention provided that at least one-half of the minimum term is satisfied by imprisonment. For offense level 12, one-half of the minimum term would be five months.

It is also noted that it currently takes a tax loss or more than $23,500 to reach level 12. Pursuant to Option 2, level 12 would be reached with a tax loss of more than $12,500. Second, the difference between retaining the specific offense characteristic of "sophisticated means" (Option 1) as opposed to replacing it with "sophisticated concealment" (Option 2) is that the language in the latter specifically pertains to overall offense conduct as opposed to offender conduct,[4] thus favorably resolving a conflict between the circuits. _See_, _United States v. Lewis_, 93 F.3d 1075 (2d Cir. 1996); _United States v. Fichman_, 93 F.3d 1085 (2d Cir. 1996); and _United States v. Kraig_, 99 F.3d 1361 (6th Cir. 1996).

Based on the foregoing, we endorse the "floor" offense level of 12 contained in both Options and the concept set forth in Option 2 which makes clear that the enhancement is offense specific rather than offender specific. However, we believe that it is unnecessary to change the enhancement from "sophisticated means" to "sophisticated concealment." "Sophisticated means" has been a specific offense characteristic in Part T of Chapter 2 of the Guidelines since their inception. Judges, defense attorneys, probation officers and prosecutors have become familiar with the term "sophisticated means" and the body of law concerning its interpretation. Changing "sophisticated means" to "sophisticated concealment" seems unnecessary and destined to cause confusion and needless litigation over whether there is a definitional difference between the two terms. We believe it is in the best interests of all concerned to retain the "sophisticated means" specific offense characteristic and supplement the commentary thereto with language that clearly establishes that "sophisticated means" is offense specific rather than offender specific.

Proposed Amendment 4 - Definition of Loss (§§2B1.1 and 2F1.1)

Proposed Amendment 4, _inter alia_, addresses competing proposals for redefining "loss" in regard to fraud and theft offenses. There is no mention of this proposed amendment relating to offenses involving taxation but, not withstanding that disclaimer, we mention it because of the concept which is present in the taxation guidelines. Both of the options in Proposed Amendment 4 define loss as the _greater_ of the actual or intended loss. Specifically, actual loss is defined to include reasonably foreseeable harm resulting from a defendant's relevant conduct. Intended loss is defined as harm

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[4] Sophisticated concealment means complex or intricate _offense_ _conduct_ that is designed to prevent the discovery of the offense or its extent.

intended to be caused by the defendant and other persons for whose conduct the defendant is accountable under the relevant conduct provision.

By contrast, for the purpose of defining tax loss, §2T1.1(c)(1) provides that the tax loss in regard to tax evasion or filing a false return, statement or other document "is the total amount of loss that was the object of the offense (i.e., the loss that would have resulted had the offense been successfully completed)." Section 2T1.1(c)(2) provides that the tax loss in regard to a failure to file violation is "the amount of tax that the taxpayer owed and did not pay." Section 2T1.1(c)(3) provides, in regard to wilful failure to pay violations, "the tax loss is the amount of tax that the taxpayer owed and did not pay" and in regard to false claims for refund violations §2T1.1(c)(4) provides that "the tax loss is the amount of the claimed refund to which the claimant was not entitled." And, §2T1.1(c)(5) provides that "the tax loss is not reduced by any payment of the tax subsequent to the commission of the offense." Although these provisions, in conjunction with existing case law, results in the greater of the intended or actual tax loss being used for determining the offense level in the tax tables, §§2T1.1, 2T1.4, 2T1.6, 2T1.7 and 2T1.9 would benefit from the inclusion of similar language as used in Proposed Amendment 4, Option 1, §2F1.1 Application Note 7.[5] In addition, this would avoid confusion as to whether the concept of loss being the greater of the actual or intended loss was applicable to the tax guidelines.

Related to Proposed Amendment 4 is also Issue for Comment (G) which is, in essence, how to deal with an intended loss pursuant to §2F1.1. The concept of this issue seems to provide the framework for Option 2 of Proposed Amendment 4. More broadly stated, the issue becomes whether the current rule should be changed to provide that a loss should be based primarily on the actual loss, with the intended loss available only as a possible ground for departure or whether, if the substance of the current rule is retained, the magnitude of the intended loss should be limited by the amount that a defendant realistically could succeed in obtaining. In other words, whether the intended loss should be limited by concepts of "economic reality" or "impossibility." We believe that the current rule should be retained with no modification for the amount that the defendant realistically could have succeeded in obtaining.

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[5] Loss is the greater of the actual or the intended loss.

Basing loss on actual loss has the potential to reward defendants for factors beyond their control. For instance, a defendant who intended a large loss but who was discovered before he/she could consummate the offense would be treated less seriously than a defendant who was not discovered until after the offense was completed. Sentencing a defendant based on the intended loss still permits courts to take into account the value of pledged collateral in cases involving fraudulently obtained loans and actual performance in cases involving falsification to obtain contracts.

In addition, basing a determination of loss on the economic reality of a defendant's scheme would require courts to make speculative judgments and quite probably would lead to similarly situated defendants being treated differently. Regardless, change is unnecessary considering the fact that the concept of current Application Note 10 to §2F1.1 which provides that, "[i]n a few instances, the loss determined . . . may overstate the seriousness of the offense . . . [and] in such case, a downward departure may be warranted" would be incorporated in Proposed Amendment 4, Application Note 7. Specifically, Proposed Amendment 4, Application Note 7 provides that "[t]here may be cases in which the loss substantially understates or overstates the seriousness of the offense or the culpability of the defendant. In such cases, a departure may be warranted." We believe that this is adequate to address the issue without encumbering the courts with restrictive definitions and special rules.

Conclusion

We recommend that the Assistant Commissioner (Criminal Investigation) submit written comments to the United States Sentencing Commission which support Option 2 of Proposed Amendment 1 and the "floor" offense level of 12 and offense specific aspects of Proposed Amendment 5. In addition, opposition should be voiced in regard to basing the determination of any loss primarily on the actual loss and limiting intended loss by concepts of economic reality or impossibility.

BARRY J. FINKELSTEIN

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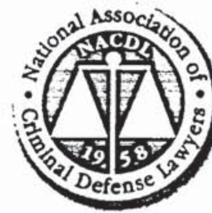

STATEMENT OF
GERALD H. GOLDSTEIN, ESQUIRE

PAST PRESIDENT,
NATIONAL ASSOCIATION OF CRIMINAL DEFENSE LAWYERS

Public Hearing
United States Sentencing Commission

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March 5, 1998
San Francisco, California

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[37]

.ie Sentencing Commission proposes to "raise penalties for economic .nses." This is wrong for three very obvious reasons.[1]

First, it flies in the face of Congress' mandate to the Commission. Congress directs us to impose a sentence that does not involve imprisonment when dealing with a "first offender who has not been convicted of a crime of violence or an otherwise serious offense."[2] There's the rub. The overwhelming majority of these nonviolent offenders who will be covered by the proposed sentencing amendments have no prior criminal history. Yet, the proposal insists on a longer prison term. This is not a rational sentencing policy.[3] Given the plainly worded mandate of Congress, I ask you how the Commission can amend the loss table to require imprisonment for a new universe of first time fraud offenders?[4] Given this same congressional mandate, how can the Commission possibly justify limiting the discretion of a federal judge to implement that mandate? How can the Commission limit a judge's ability to impose a sentence of home-detention and community confinement when in his or her considered judgment that is the appropriate sentence, and that sentence would plainly appear to be what Congress envisioned for this class of defendants?

Second what we have here is one bad policy begetting a worse sentencing policy. The Commission's stated reason for contravening Congress and for limiting judicial discretion is to achieve better proportionality. For what, for the sake of proportionality? The primary source of that disproportionality is the penalties for crack cocaine offenses. The Commission is on record, with a 242-page report followed by shorter report, that crack cocaine penalties were, and still are, too severe.[5] The Commission recommended that the crack cocaine penalties should be reduced. But they haven't been. So now you propose to increase the penalties for fraud and other so-called "white-collar" offenses "to achieve better proportionality with the guideline penalties for other offenses of comparable seriousness." But that makes no sense, particularly if the relationship between other crimes, at least when it comes to sentencing is arbitrary. While Congress, as a legislative body, is free to act for political reasons this Commission is not. Two wrongs have never added up to a right, and they still don't.

Third, and perhaps this is a corollary of my first and second reasons, increasing penalties and the likelihood of imprisonment without good reason to do so is not justified. Indeed, it is shameful. The Commission is charged with developing sentencing guidelines that "provide certainty and fairness"

d on rational distinctions. 18 U.S.C. § 991. As the Supreme Court explained just last summer:

> The goal of the Sentencing Guidelines is, of course, to reduce unjustified disparities and so reach toward the evenhandedness and neutrality that are the distinguishing marks of any principled system of justice.

Koon v. United States, 116 S. Ct. 2035, 2053 (1996). Anecdotal reports that may be driving the concern about an unjustified disproportionality between fraud and other offenses should not form the basis for the Commission's proposed enhancements when the empirical evidence does not justify the enhancements.

The Commission's own data reflect that most fraud defendants are being sentenced at the low end of the range calculated under the current guidelines. If judges in fact believed that current penalties for fraud defendants were too lenient, they would sentence at the high end of the range. In fact, 70% of fraud defendants who are eligible for non-prison sentences are being sentenced to sentences that do not include imprisonment.[6] Judges are also not departing up in cases involving fraud.[7]

In addition, fraud sentences were set disproportionately higher

[40]

ences for other offenses when the Commission first formulated uidelines. In 1989, the Commission once again raised the penalties or fraud offenses, without any intervening congressional action or other empirical evidence. This will have been the third time that these sentences have been raised without empirical support. This is not the role Congress entrusted to the Commission.

The Commission should not increase the loss table or otherwise enhance the penalties for fraud and the related theft and tax offenses.

ENDNOTES

1. This year, the Sentencing Commission is proposing substantial increases in the penalties for white collar offenses. Half of the amendments the Commission has published this year for public comment relate to theft, fraud and tax offenses.

> During the 1997-98 amendment cycle, the Sentencing Commission has identified as a priority issue for consideration the definition of "loss" and the weight it is given in the theft, fraud, and tax guidelines. **The purpose of both options is to raise penalties for economic offenses that have medium to high dollar losses in order to achieve better proportionality with the guideline penalties for other offenses of comparable seriousness.**

U.S.S.C., Synopsis of Proposed Amendment 1, 63 Fed. Reg.--- (Jan. 6, 1998) (emphasis added).

2. In relevant part, 28 U.S.C. § 994(j) provides:

> The Commission shall insure that the guidelines reflect the general appropriateness of imposing a sentence other

than imprisonment in cases in which the defendant is a first offender who has not been convicted of a crime of violence or an otherwise serious offense . . .

3. The Commission's statistics reflect that 62% (2360/3801) of fraud offenders sentenced to terms of imprisonment are in Criminal History Category I. U.S. Sentencing Commission, 1996 Sourcebook of Federal Sentencing Statistics, Table 14 at 24 (1996). It would appear, furthermore, that an additional 10 to 15% of fraud offenders, those who receive no sentence of imprisonment, also have limited or no prior criminal history. Compare Id. at n.1 with Table 3 at 7. The statistics also reflect that an even higher percentage of tax offenders who are sentenced to terms of imprisonment, (77% or 255/331) are in Criminal History Category I.

Generally, the percentages for 1995 were the same as those for 1996. U.S. Sentencing Commission, Annual Report, Table 19 at 62 (1995) (62 % (2262/3638) of fraud offenders sentenced to terms of imprisonment were in Criminal History Category I; 73% (195/266) of imprisoned tax offenders were in Criminal History Category I).

4. The proposed loss tables will require a full term of imprisonment (zone D) for all first time offenders engaged in fraud offenses involving a loss in excess of $70,000 (option 2) or $80,000 (option 1) down from the current amount of $120,000 or more. Similarly, to obtain home detention or community confinement without requiring that any part of the sentence be satisfied by imprisonment (zone B), currently the loss cannot exceed $ 40,000; under the proposed amendment (option 2), the loss cannot exceed $30,000 to obtain a sentence in zone B.

5. U. S. Sentencing Commission, Special Report to the Congress: Cocaine and Federal Sentencing Policy, (as directed by § 280006, Pub. L. 103-322), Feb. 1995; U. S. Sentencing Commission, Special Report to the Congress: Cocaine and Federal Sentencing Policy, (as directed by § 2, Pub. L. 104-38), Apr. 1997.

6. U. S. Sentencing Commission, 1996 Sourcebook of Federal Sentencing Statistics, Figure F, at 28 (1996).

7. Upward departure were imposed in only 1.3% of fraud cases. U. S. Sentencing Commission, 1996 Sourcebook of Federal Sentencing Statistics, Table 27, at 44 (1996).

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Statement of David F. Axelrod
Vorys, Sater, Seymour and Pease LLP
to the United States Sentencing Commission
March 5, 1998

Introduction

Thank you for this opportunity to address a topic of great importance. I appear today to discuss the proposed "More than Minimal Planning" ("MMP")[1] and "Sophisticated Concealment" amendments that would apply to fraud and theft cases (which I will refer to simply as the "Proposed Amendments"). As a practicing attorney who deals with the Guidelines almost every working day, I hope to help you focus on the "real-world" effects those proposed amendments may have on individuals and trial courts.

I testify from the perspective of one who has wrestled for years with Guidelines issues, both as a prosecutor and defense attorney. My first exposure to fraud cases came as a young associate in a law firm that specialized in white collar defense. I subsequently served as a federal prosecutor for seven years, during which I focused on the prosecution of economic crimes. In the middle of my prosecutorial career, the implementation of the Guidelines immediately and dramatically changed the nature of my job. Several years later, I returned to private practice in Columbus, Ohio, where I focus on the defense of economic crimes.

[1] For consistency and convenience, this testimony adopts the MMP abbreviation as it is used by the Commission in the Proposed Amendments.

I. Operative Principles

There are several principles that should guide consideration of the Proposed Amendments. They are, in my opinion, principles which should be applied to all aspects of the Sentencing Guidelines. Some represent my own value judgments; others represent views previously expressed by the Commission. I identify those that I believe most important in this context:

1) Simplicity in the Guidelines is desirable. In the Commission's own words, "The larger the number of subcategories of offense and offender characteristics, the greater the complexity and the less workable the system.... The greater the number of decisions required and the greater their complexity, the greater the risk that different courts would apply the guidelines differently to situations that, in fact, are similar, thereby reintroducing the very disparity that the guidelines were designed to reduce." U.S.S.G. Ch. 1., Pt. A.3.

2) Special Offense Characteristics invite litigation.

3) Each relevant factor should be considered only once in the imposition of a criminal sentence. No factor should be double or triple-counted.

4) Judges should retain significant flexibility to deal with differing offenses and offenders. Again in the Commission's own words, "The appropriate relationships among ... different factors are exceedingly difficult to establish, for they are often context specific." U.S.S.G. Ch. 1, Pt. A.3.

II. General Comments on the Proposed Amendments.

My preference is that the Proposed Amendments not be adopted. As noted above, I believe that the Guidelines should be kept as simple as possible, and that

judges must retain the flexibility to consider the context in which each factor exists and the relationships among them. More importantly, my experience in dealing with the Guidelines for almost ten years teaches that the addition of specific offense characteristics will magnify the complexity of the sentencing process without improving the quality of justice.

Additional Offense Characteristics add complexity by encouraging litigation over their existence in almost every case. On the other hand, the concerns that underlay the Proposed Amendments may be addressed without incorporating this undesirable side-effect. The sophistication of an offense may presently be considered in selecting the defendant's offense level within the guideline range. To the extent that greater flexibility is desired, the Commission may add commentary that explicitly recognizes judges' authority to depart upward in cases of unusual sophistication, and downward in cases involving only minimal planning.

However, if current proposals are adopted, it is essential that it not be done piecemeal. To the contrary, the Commission should consider the Proposed Amendments only in context of an overall plan for how culpability in fraud and theft cases should be determined. Therefore, if new Offense Characteristics are adopted, they should consist of a three-tiered structure that would provide judges with sufficient flexibility to deal with different gradations of complexity and concealment, including:

1) Incorporation of the MMP enhancement into the loss tables for fraud and theft;

2) Adoption of the Practitioners' Advisory Group's proposal for a two-level reduction in the fraud and theft guidelines for cases that involve only limited or insignificant planning; and

3) Adoption of a two-level enhancement for Sophisticated Concealment.

I strongly oppose other changes that would result in unjustified increases in the lengths of sentences under the fraud and theft guidelines. The most significant of those changes would increase the loss tables substantially more than necessary to incorporate the MMP enhancement, even at middle levels of the loss tables. The Proposed Amendments state that such additional increases are to achieve better proportionality with the penalties for comparable offenses. The Proposed Amendments neither identify such comparable offenses, nor offer empirical data to support the proposed changes.

I place in the same category the proposed "floor" offense level of 12 for crimes involving Sophisticated Concealment. It is reasonable to infer that, even without this feature, most crimes that may be categorized as involving Sophisticated Concealment will score at level 12 or more because they will involve significant sums or will constitute money laundering. Nevertheless, experience teaches that zealous prosecutors will advocate this enhancement for even low level crimes. Where such offenses involve only a small amount of money, a two level increase is sufficient to penalize the additional culpability involved in efforts at concealment.

My overall concern as a defense lawyer, and as one who is forced to view the results of such proposals in human terms, is that offense levels not creep upward without sufficient evidence that increases are necessary or appropriate, especially at the

lower and middle levels of the loss tables. Across-the-board increases should not be approved without a much better foundation than presently exists. Therefore, I strongly urge that any increases at the lower and middle levels be confined to the two levels necessary to compensate for the elimination of MMP as a specific offense characteristic, and that the Sophisticated Concealment enhancement also be limited to two levels.

The comments which follow are applicable only if the Commission decides to amend the fraud and theft guidelines, and should not be understood as detracting from my overall opposition to the Proposed Amendments.

III. MMP Is Inherent in Most Thefts and Frauds.

The present MMP specific offense characteristic may be unsatisfactory in that it defines the covered conduct so broadly that it literally applies to any fraud or theft that was not "purely opportune." U.S.S.G. § 1B1.1, Application Note 1(f). "More than 80% of all defendants sentenced under the fraud guideline and nearly 60% of those sentenced under the theft guideline are assessed the two additional levels for more than minimal planning."[2]

In the present Guidelines structure, the MMP enhancement may also be too inflexible in providing judges with only two options (to enhance or not). Consequently, it may not sufficiently assist sentencing judges in distinguishing among simple, moderately complex and highly sophisticated criminal schemes.[3] As noted above, I believe these deficiencies can be addressed by recognizing the sophistication of an offense, or its lack of sophistication, as possible reasons for departure.

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[2] Bowman, Coping With "Loss": A Re-Examination of Sentencing Federal Economic Crimes Under the Guidelines, ___ Vand. L. Rev. ___, Manuscript at 50 (1998) ("Coping With Loss") (citing U.S. Sentencing Commission, 1995 Datafile MONFY 95).

[3] Coping With Loss, Manuscript at 50-51.

My personal experience supports the view that most frauds involve MMP. Indeed, I have rarely seen a court decline to apply this adjustment in a fraud case, as is apparent in the reported cases. For instance, in United States v. Pooler, 961 F.2d 1354 (8th Cir. 1992), the enhancement was applied where a bank official made a single false entry in the bank's books. In United States v. Sanchez, 914 F.2d 206 (10th Cir. 1990), the enhancement was applied in a simple case of fraud by unauthorized use of a credit card, even though the defendant did nothing but use the card, since "[e]ach purchase involved several calculated falsehoods including a forged signature." Id. at 207. In United States v. Fox, 889 F.2d 357 (1st Cir. 1989), the Court stated that "[w]e cannot conceive of how obtaining even one fraudulent loan would not require more than minimal planning." In United States v. Garcia, No. 96-2453, 1996 U.S. App. LEXIS 31074 (7th Cir. Nov. 26, 1996), the MMP enhancement was predicated on the repetitive nature of the defendant's conduct, despite the Court's conclusion that the scheme was not complex.

The enhancement is also applied in the majority of theft cases, often on remarkably simple facts. For example, in United States v. Harrison, 42 F.3d 427 (7th Cir. 1994) the Court applied the enhancement where a contract custodian had removed envelops containing food stamps from a cart in the post office. The defendant's efforts at observing Post Office operations to ascertain the location of the envelops containing food stamps warranted the sentencing enhancement. Id. at 432-33.

I concede that an enhancement that applies in the majority of cases may lose meaning as a specific offense characteristic. Nevertheless, it should be incorporated in the loss tables *only* as part of a larger picture that includes a two level *reduction* for

defendants whose crimes involved *less* planning than is typical for commission of the offenses in a simple form.

IV. The Multiple Victim Enhancement Should Not Be Retained.

If MMP is incorporated in the loss tables, I oppose retention of the two-level enhancement for "a scheme to defraud more than one victim" that is presently contained in U.S.S.G. § 2F1.1(b)(2)(B). This enhancement currently exists as an alternative to the MMP enhancement. Thus, under the current system, a defendant's sentence may *not* be enhanced for *both* MMP and the involvement of multiple victims. This limitation makes sense since it is reasonable to infer that MMP exists in virtually every multiple victim case, and it therefore would be redundant to increase a defendant's sentence for both reasons.

Retention of the multiple victim enhancement in addition to incorporating MMP into the loss tables will *double* the potential sentencing increase. The proposal notes that empirical evidence is not well developed, and the Guidelines should not be changed unless and until strong empirical evidence demonstrates that such a change makes sense.

V. "Sophisticated Concealment" is a Legitimate Consideration in Sentencing.

The addition of a Sophisticated Concealment specific offense characteristic would complete the proposed three-tier measure of culpability. For the reasons stated above, I prefer identifying Sophisticated Concealment as a potential ground for departure, but acknowledge the validity of increasing a defendant's sentence for this reason.

Conduct that readily warrants an enhancement for more than minimal planning does not necessarily rise to the level of sophisticated concealment. See United States

v. Madoch, 108 F.3d 761, 766 (7th Cir. 1997) (conduct that "does not necessarily demonstrate 'sophisticated means' . . . may show 'more than minimal planning'"). The distinction is workable. For instance, United States v. Rice, 52 F.3d 843 (10th Cir. 1995) involved a false tax refund scheme. Because the defendant was convicted of offenses under both Titles 26 and 18, the Court had the option of applying both the MMP enhancement, and the enhancement for sophisticated means to impede discovery under § 2T1.1(b)(2). The Court found that the scheme was unsophisticated but persisted over three years, and therefore increased the sentence for MMP but not for sophisticated means to conceal. Id. at 849-50. Similarly, In United States v. Bhagavan, 911 F. Supp. 351 (N.D. Ind. 1995), the court refused to enhance the sentence in a tax evasion case for sophisticated means, although it noted that the defendant's conduct would have warranted an enhancement for more than minimal planning.

VI. The Sophisticated Means Enhancement Should Apply to Overall Offense Conduct Only if Reasonable Foreseeability Requirements are Strictly Applied.

The proposed enhancement specifically raises the question whether it should be limited to the personal conduct of the defendant, or reach the overall offense conduct for the which the defendant is accountable. The latter approach was used in drafting the Proposed Amendment.

Consideration of this issue must occur in the overall context of the Sentencing Guidelines. U.S.S.G. §1B1.3 ("Relevant Conduct") establishes the framework under which all Guidelines, including specific offense characteristics, are applied. Referring to § 1B1.3(a)(1)(B), Application Note 2 to that section states that:

> a defendant is accountable for conduct (acts and omissions) of others that was both:

(i) in furtherance of the jointly undertaken criminal activity; and

(ii) reasonably foreseeable in connection with that criminal activity.

This reasonable foreseeability requirement should limit the reach of the proposed enhancement. In other words, no defendant's sentence should be increased for acts of concealment by others that were not reasonably foreseeable to him or her.

Reasonable foreseeability is employed as a measure of culpability in both the criminal law in general, and the Sentencing Guidelines in particular, to avoid punishing defendants for harm that was neither intended nor could reasonably have been anticipated. On the other hand, defendants may appropriately be punished based on harms that they intend or that obviously will follow from their conduct.

Reasonable foreseeability, however, means different things in different contexts. Because the sentencing process focuses on culpability, it is appropriate for the requirement to be strictly construed in this context. Before increasing a sentence based on acts by third parties, the sentencing court should require that a reasonable person in the defendant's position would have foreseen the harm in question as a probable result.[4] This is considerably more specific than the definition presently contained in the Guidelines. Therefore, I urge the Commission to include additional commentary to more clearly define what is deemed reasonably foreseeable for purposes of the Sophisticated Concealment enhancement in particular, and sentencing in general.

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[4] Coping With Loss, Manuscript at 144-45.

VII. "Committing the Offense From Outside the United States" Should be Included as One Form of Sophisticated Concealment Rather Than as an Alternative Enhancement.

Two options are proposed for the Sophisticated Concealment enhancement. Under Option 1, the commission of any part of the offense from outside the United States would be an alternative ground for enhancement. Option 2 would have an application note state that the commission of an offense from outside the United States is ordinarily indicative of sophisticated concealment.

Option 1 is overbroad. It is easy to imagine offenses in which trivial activity outside the United States would be urged by the government to trigger the enhancement. For example, the existence of a single mail fraud victim across the Canadian border from Detroit arguably would trigger the enhancement under Option 1, even though the offense might otherwise be crude and unsophisticated.

Furthermore, such an overly-specific offense characteristic is entirely unnecessary. Option 2 would provide judges with sufficient flexibility to punish the use of foreign bank accounts, etc., wherever common sense dictates.

VIII. The Loss Tables Should be Not be Amended More Than Necessary to Incorporate MMP.

Elimination of MMP as a specific offense characteristic would result in a two level across-the-board reduction unless a compensating adjustment is made elsewhere. However, the current proposals to amend the loss tables would increase sentences, even at lower levels, much more than necessary to compensate for the elimination of the MMP offense characteristic, and therefore should be rejected.

Both proposals recognize the obvious correlation between the amount of money involved in a fraud or theft, and its planning and sophistication. Smaller, simpler offenses are indicative of a less culpable mental state. Therefore, the Proposed Amendments would appropriately refrain from increasing sentences at the lower end of the loss tables. Where larger losses are involved, the revised tables would increase the sentences to punish the greater sophistication and planning that is ordinarily involved.

However, the line of loss demarcation is drawn too low. Under Option 1, MMP would be presumed for all offenses involving more than $5000. Under Option 2, the increase would start at offenses involving as little as $2000. The level at which such increases should begin is partly a value judgment. However, even $5000 cannot be considered a large sum in our present economy. Therefore, I suggest that MMP not be presumed in offenses involving less than a significantly larger amount.

I find even more disturbing proposals that would increase sentences at the middle levels of the guidelines far more than necessary to account for the incorporation of MMP. For instance, Option 2 would result in a three level increase over the present loss table for offenses involving more than $40,000 and a five level increase for offenses involving more than $150,000. Throughout the middle levels, Option 2 would increase sentences by approximately 40% to 50%. No justification is offered other than the vague suggestion that this would make fraud sentences more proportionate to sentences for unspecified other offenses.

Recognition that loss is a proxy for other sentencing factors, including mental state, becomes explicit with the incorporation of MMP in the loss tables. However, even if one concedes that sentences should be increased for truly high-level offenses,

increases beyond that are unjustified. Additional increments of sophistication and planning may be punished through upward departures or the two-level enhancement for Sophisticated Concealment. In most cases, to include the Sophisticated Concealment enhancement *on top of* already increased offense levels would be to punish the same conduct twice.

IX. Justice Requires That a Downward Adjustment be Permitted for Cases of Limited or Insignificant Planning.

The Commission's Practitioners' Advisory Group suggests a two-level reduction for cases of limited or insignificant planning if the MMP enhancement is incorporated into the tables. I strongly support such a recommendation. If MMP is incorporated into the Guidelines, the Commission should preserve a mechanism to deal with "purely opportune" conduct. The best way to do so would be to permit a reduction for insignificant or limited planning.

Conclusion

I am concerned that the overall result of the Proposed Amendments may be unjustified increases in a broad category of sentences, and penalizing the same conduct several times. I urge the Commission to exercise care not to include specific offense characteristics that are overbroad, or would punish the same conduct that is used to justify increases in the loss tables.

I thank the Commission and its able staff for permitting me the opportunity to share these views with you. I will be happy to answer any questions you may have.

6

PREPARED STATEMENT
of
MARK FLANAGAN
to the
UNITED STATES SENTENCING COMMISSION

March 5, 1998 Public Hearing

Let me begin by thanking the Commission for extending to me an invitation to testify in the March 5, 1998 public hearing. I welcome the opportunity. I have closely followed the Commission's efforts this past year to clarify and to improve the definition of loss as used in the Theft and Fraud guidelines. The views expressed here are refinements of those presented in my article published last September in *The Legal Times*. I am appearing in my capacity as a member of the private defense bar.

Introduction

The Commission has proposed numerous amendments relating to the guidelines for Fraud and Theft, but, in my view, Proposed Amendment No. 4--the definition of "loss"--is by far the most critical. "Loss" is the bedrock upon which the guidelines for fraud and theft rest. Indeed, the calculation of a sentence begins with the calculation of loss. A fair and uniform application of the loss tables depends upon this concept.

Nonetheless, the current guidelines definition has no causation requirement, and places no true limit on the amount of damages for which a defendant can be held responsible. The guidelines all but eliminate the connection between a defendant's act, the effect of the defendant's act, and the defendant's punishment. There is no clear definition of loss, and as a result,

different courts use different approaches when measuring loss, and different defendants get different--and perhaps unjust--sentences.

The Commission's Proposed Amendment No. 4, as refined in its February 1998 Working Draft, goes a substantial way towards accomplishing the Commission's mission to promote uniform and just sentences. The first order of business, as reflected in these papers, must be to better define loss. The February Working Draft already captures much of what needs to be done, and in and of itself represents a remarkable improvement and many hours of hard work. My comments below are intended to emphasize the compelling need to go forward with the concepts embodied in the February Working Draft and to consider additional revisions to make it even better.

Within this context, I believe the Commission could markedly improve the definition of loss if it were to do the following: 1) Define and adopt, as proposed, a "reasonably foreseeable" causation standard; 2) Eliminate "intended loss" from the definition of loss, and use it only as a grounds for departure; 3) Eliminate, as proposed, consequential damages as a term used in the definition of loss, and predicate loss on the recovery of reasonably foreseeable damages only; and 4) Eliminate defendant's gain from the definition of loss, and use it only as a grounds for departure.

Add A Causation Element

The most serious flaw of the current definition is that there is no causation requirement. Under the current guidelines, loss can conceivably include *all* harm, no matter how remote, from the acts or omissions of a defendant. Section 1B1.3(a)(3) defines "harm" to include "all harm" resulting from a defendant's acts

or omissions, and the guidelines state that loss need not be determined with precision. This combination of holding a defendant responsible for "all harm" while at the same time applying a loose standard of proof does not promote fairness, uniformity, or proportionality in sentencing. A court may hold a defendant criminally responsible for losses that were, at best, remotely caused and unforeseen. But if a purpose of the guidelines is to deter a defendant's conduct, the defendant only should be held liable for the reasonably foreseeable results. The guidelines cannot justly deter conduct that has unforeseeable results.

That is why the single most important improvement offered by Proposed Amendment No. 4 and the February Working Draft definition of loss is the addition of the "reasonably foreseeable" standard. For the first time since the introduction of the U.S. Sentencing Guidelines, the Commission has proposed a recognizable link between a defendant's criminal conduct and the damages caused by that conduct. This causation standard puts coherent limits on the amount of harm attributable to a defendant. It will prevent such anomalous sentences as in United States v. Neadle, 72 F.3d 1104 (3rd Cir. 1996), where a defendant who had posted a $750,000 bond to open an insurance company was held responsible $20 million in unpaid property damage that resulted from a hurricane. The Court in Neadle imposed a sentence on the defendant without applying any causation standard whatsoever.

I strongly support the Commission's effort to define loss by introducing the "reasonably foreseeable" standard. But it must go a step further by defining "reasonably foreseeable;" if it does not, it will be left to the courts to define this causation standard and the results may vary. For example, the Commission

should consider adopting the definition offered by Professor Frank Bowman in his proposed definition of loss set forth in his law review article scheduled for publication this Spring. The definition defines "reasonably foreseeable" as harm that "ordinarily follows from one or more of the acts . . . in the usual course of events, or that a reasonable person in the position of the defendant would have foreseen as a probable result." Adopting such a definition will promote uniformity of interpretation.

Eliminate Intended Loss From Definition of Loss

Section § 2F1.1, Application Note 7(b) of the current guidelines specifies that "where the intended loss is greater than the actual loss, the intended loss is to be used," but nowhere in the guidelines is "intended loss" defined. I understand that use of "intended loss" is primarily meant to ensure that inchoate crimes are punished, but "intended loss" is an unnecessarily vague concept which seems to require a court to analyze a defendant's deepest thoughts on what the benefits of a particular crime might be. It is a complex and uncertain analysis, and depends not on evidence of what the defendant actually did, but what the defendant had hoped, thought, or dreamed of doing. It is time consuming, with no uniform result. It should be employed in limited circumstances only, not in the ordinary course.

Unfortunately, Proposed Amendment No. 4 and the February Working Draft definition retain "intended loss" as a key component. Both provide that loss is the "greater of the actual loss or the intended loss," thus requiring a court to contemplate intended loss in every case. Using "the greater of the actual loss or the intended loss" is unduly confusing because it requires the court to choose

between the objective standard of "reasonably foreseeable" and the subjective standard of "intended loss." While in a perfect world, with unlimited resources and time, it might be preferable for a court to always consider what intended loss might be, we do not live in such a world.

The solution is to remove "intended loss" from the definition of loss and to make it available as a possible grounds for an invited departure to cover those limited cases when a defendant's intended gain is so markedly different from the actual loss that a different punishment is warranted. In the ordinary case, though, the defendant should only be held responsible for the actual loss caused.

Eliminate Consequential Damages

The current guidelines single out procurement fraud and product substitution cases as the only cases where consequential damages are recoverable. The sole justification given for limiting consequential damages to these two types of cases is the summary and questionable assertion in § 2F1.1, Application Note 7(c), that such damages "frequently are substantial." Singling out these cases also implies that all other cases are limited to direct damages. The result is that there is confusion among the courts as to whether to include consequential damages.

The February Working Draft definition of loss resolves this issue. By adopting a "reasonably foreseeable" standard, the Commission has obviated the need to include the term consequential damages in the guidelines. Under the reasonably foreseeable standard, a defendant will be held liable for damages that are foreseeable. There is no need to attempt to apply a consequential damages analysis to determine if the damages are immediate and direct or indirect; include

only those damages that are reasonably foreseeable regardless of whether they are direct and immediate or indirect damages.

But for one caveat, I recommend that the Commission proceed with its proposal to eliminate the term consequential damages from the guidelines, and to use only the reasonably foreseeable standard. The caveat concerns the suggestion that costs incurred by government agencies in a criminal investigation or prosecution of a defendant routinely should be considered reasonably foreseeable damages. I disagree. The Commission should consider adding language to the definition of reasonably foreseeable, as Professor Bowman has proposed in his article, to make it clear that loss does not include such costs.

Make Gain a Departure

The current guidelines seem to allow courts to use the offender's gain as the measure of loss instead of the victim's loss. See § 2F1.1, Application Note 8. The February Working Draft definition of loss expressly incorporates gain as a factor in the determination of loss. The Commission should not include gain in the definition of loss because it muddles the calculation of loss. To simplify and to promote clarity and uniformity, the Commission should focus only on the harm to the victim when determining loss. For those unusual cases when the loss does not reflect the seriousness of the offense, or when gain is vastly lower than the actual loss, the Commission should propose language to invite an upward or downward departure. For example, a defendant who is only a pawn or functionary--like an employee of a corporate defendant in a complex white collar case--may gain little or none of what the victim has lost. In such cases, it may well be unfair to sentence the individual based on actual loss.

Conclusion

My colleague, Will O'Brien, and I focused on the proposed amendments to the Theft and Fraud Guidelines when we realized that the Commission was considering amending the loss tables without correcting the defects in the definition of loss. Since then, various groups from a variety of sources have urged the Commission to tackle the tough issue of defining loss either before or together with amending the loss tables. It is a tribute to the Commission that it has acted so swiftly to meet this challenge.

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TESTIMONY BEFORE THE U. S. SENTENCING COMMISSION

MARK E. MATTHEWS
DEPUTY ASSISTANT ATTORNEY GENERAL
TAX DIVISION
DEPARTMENT OF JUSTICE

SAN FRANCISCO, CALIFORNIA
MARCH 5-6, 1998

Good morning. I am Mark Matthews and I am pleased to appear before the Commission today on behalf of the Tax Division. My testimony today will focus on the need for increased severity in the tax table, especially at the lower range of the table, in order to ensure a substantial likelihood of some prison time for more defendants convicted of tax violations. I also will speak about our support for certain proposed changes and clarifications in the "sophisticated means" enhancement in criminal tax cases. The Commission came very close to making such changes last year, and it should not allow another amendment cycle to pass without taking action to promote increased deterrence in criminal tax cases.

One of the primary goals of the Tax Division is to promote the public's voluntary compliance with the federal tax laws through the investigation and prosecution of violations of the federal criminal tax laws. We believe that by prosecuting and punishing those who violate our tax laws, we deter others who might be contemplating similar conduct.

We are faced, however, with the task of deterring more Americans (over 200 million) with fewer prosecutions (approximately 1500) than any other area of law enforcement. By way of contrast, a much smaller percentage of the American public is even remotely likely to consider committing an offense against our narcotics statutes, yet we appropriately bring many more such prosecutions against such violators with much greater sanctions at our disposal. In the tax administration business, our goal is not primarily to punish clearly unlawful conduct, but to influence hundreds of millions of Americans every year to take

the affirmative steps of honestly filling out and filing often complex tax returns and making substantial payments to Uncle Sam.

Our central concern is with those otherwise law-abiding citizens who might be tempted to cheat on their taxes. Almost all Americans are required to file income tax returns. Consequently, large numbers of citizens are presented with an annual opportunity on April 15 to cheat on their taxes. These potential tax violators are our primary concern and the focus of our mission.

By any measure, ours is a difficult mission. One measure of our success is the "tax gap," or the difference between what should be reported as owing and paid to the Government each year on legal source income versus what is actually reported and paid. That figure is currently estimated to be in excess of $100,000,000,000 ($100 Billion) per year. The IRS estimates that the compliance rate is approximately 83%.

We cannot afford to let that compliance rate drop any further. As my boss, Assistant Attorney General Loretta C. Argrett of the Tax Division, wrote to Chairman Conaboy last April:

> To maximize the deterrent value of criminal tax prosecutions and to reverse or limit the increasing tax gap, we desperately need to enhance the probability of imprisonment in more tax cases.

If taxpayers perceive that they can cheat the system without suffering any serious consequence, they will be less inclined to comply with the law and more willing to take the chance of not reporting and paying all the taxes that they owe. We believe that the prospect of a fine, home detention, or confinement in a halfway house does little to dissuade anyone tempted to cheat on their taxes. The idea, however, that one will spend time in jail if caught and convicted of a tax violation is a powerful disincentive to willfully disobeying the tax laws. As the Commission itself has stated in discussing certain economic crimes, including tax evasion, "the definite prospect of prison, even though the term may be

short, will serve as a significant deterrent, particularly when compared with pre-guidelines practice where probation, not prison, was the norm." United States Sentencing Commission, Guidelines Manual, Ch.1, Pt. A-Introduction, 4(d), p.s. -- The Guidelines' Resolution of Major Issues-Probation and Split Sentences.

We believe that, unfortunately, the current Tax Table does not do a good enough job of making the possibility of imprisonment upon conviction for a tax violation enough of a realistic threat for many taxpayers. For example, the Commission's own statistics, as reflected in its 1996 Annual Report, reveal that for the total universe of federal criminal cases sentenced in Fiscal Year 1996, more than 80% of all guideline sentences included a term of imprisonment and only 11.5% of defendants sentenced received straight probation. In contrast, in tax cases, only 40% of all guideline sentences included a term of imprisonment, while 60% of the convicted defendants received a

sentence including probation and more than 30% received a term of straight probation.

The need for higher offense levels at lower loss amounts is brought into even sharper focus when one considers the number of individual taxpayers who actually face a real risk of imprisonment under the guidelines. Under the current guidelines, because almost 88% of convicted tax defendants receive a reduction for acceptance of responsibility, the certainty of prison time is generally faced only when the loss amount exceeds $40,000. Below that amount, most tax defendants can fall into Zone B or lower, and, thus, receive a sentence that does not require imprisonment. But the number of taxpayers who could cheat on their taxes to the tune of $40,000 is minuscule. For tax years 1992 through 1995, somewhere between 95% and 97% of the individual income tax returns filed reported an adjusted gross income of $100,000 and less. The average tax liability reported for those years in the adjusted gross income range of $75,000 to $99,999 was between

$12,625 and $12,936. In other words, if those approximately 95% of all individual taxpayers cheated on every dollar of tax liability for three consecutive years, they still would not reach the $40,000 tax loss level that would guarantee them some prison time under the guidelines. Only by increasing the offense levels at lower dollar amounts can the risk that most taxpayers face the likelihood of prison time become something more than a theoretical possibility.

Among the various tax loss table options, our clear preference is Option 2 of the published version, although the April 1997 staff proposal, to which we agreed last year, is also acceptable. Except between a tax loss of $1,701 and $2,000, Option 2 and the April 1997 staff proposal tables would be higher than the existing tax table, thereby increasing the likelihood of prison exposure. Both tables also move tax violators beyond offense level 12 (to offense level 14) more quickly than does the current table (at the $30,000 tax loss level rather than at the $40,000 level), thus making it impossible to reach, through an

acceptance of responsibility reduction, Zone B and a sentence that does not require the service of any prison time. Moreover, large losses are punished much more severely under both of these proposals. We prefer Option 2 to the April 1997 staff proposal because of the slightly lower loss amount breakpoints in Option 2 at mid to upper level income ranges.

The Commission also seeks comments on several proposals regarding "sophisticated means," an enhancement that has been a part of the tax guidelines since the inception of the Sentencing Guidelines. We support the Commission's proposal to add a floor of "12" to the enhancement. We also endorse the Commission's proposal to resolve a circuit conflict by clarifying that the sophisticated means enhancement is offense, rather than offender, specific. That the enhancement is offense specific is consistent with the "relevant conduct" provisions of the Guidelines, and enhancements and reductions related to offender characteristics are already covered in the role-in-the offense provisions.

Moreover, one does not have to be the creator of the sophisticated means used to impede discovery of the existence or extent of the offense to benefit from them. The fact that the defendant did not create the sophisticated means but merely utilized them does not make his or her scheme any easier to detect or punish.

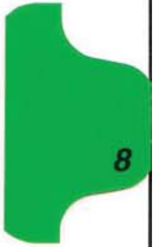
We would urge the Commission to include in Appendix C, as reasons for the amendment, language similar to that employed in the synopsis to the proposed amendment to the "sophisticated means" enhancement in tax cases published in the Federal Register. This will make clear that the enhancement applies based on the overall offense conduct for which the defendant is accountable and not the personal conduct of the defendant. In this way, the Commission's purpose and intent regarding its resolution of the circuit conflict in this area will be plain. In our view, the mere language of the proposed guideline modification is cryptic and needs additional amplification by way of background.

We believe that of the two proposals in this area, Option 1 is far superior. "Sophisticated means" has been a specific offense characteristic in the Chapter 2, Part T guidelines since their inception. A body of law has developed concerning its interpretation, and interested parties (i.e., judges, defense attorneys, defendants, probation officers and prosecutors) have become accustomed to dealing with this definition. Changing the definition of this sophisticated offense characteristic potentially would confuse and complicate sentencing proceedings without any demonstrated benefit flowing from the proposed change.

The proposed change in Option 2 narrows the scope of the sophisticated means enhancement to sophisticated concealment. No claim is made, nor can it be made, that the dramatic changes proposed by Option 2, the "sophisticated concealment" option, are necessary. Moreover, Option 2 dilutes the language of the existing guideline that the enhancement applies where the offense involved the use of foreign bank accounts or foreign transactions, or transactions through corporate

shells or fictitious entities for language that such actions "ordinarily indicate" sophisticated concealment. In our view, absolutely no case has been made for the need to adopt Option 2, much less propose its adoption.

In closing, I would again like to thank the Commission for the opportunity to appear before it and present the case for meaningful deterrence in criminal tax enforcement through enhanced offense levels at virtually all income levels.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U.S. Sentencing Commission Hearing, March 5, 1998
PREPARED STATEMENT:

Frank Bowman
Gonzaga University School of Law

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. "Loss" Is a Measurement of Economic Harm

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. Is It Prudent to Include in "Loss" Harms "Reasonably Certain" to Occur in the Future?

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. Time of Measurement of "Loss" Should Not Be Part of the Core Definition

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. The Definition of Intended Loss

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. <u>Departure for "inept manner"</u>

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

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[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) Interest. 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. "Credits Against Loss" and Time of Measurement

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) Interest. 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

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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).

room case, this would involve hundreds or even thousands of different valuations.

(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

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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).

practical and theoretical drawbacks.

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.

not necessarily /

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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).

b) Credits Against "Loss":

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

why draft?

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).

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

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