

Testimony
Before the United States Sentencing Commission
March 5, 1998, San Francisco, CA

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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.