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On Behalf of the Federal Public and Community Defenders

Before the United States Sentencing Commission

Public Hearing on Dodd-Frank Act/Fraud Offenses

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My name is Kathryn N. Nester and I am the Federal Public Defender for the District of Utah. I would like to thank the Commission for holding this hearing and giving me the opportunity to testify on behalf of the Federal Public and Community Defenders regarding Dodd-Frank Act/Fraud Offenses.

My testimony will focus on two aspects of the Commission's proposed amendments: (1) the impact of the loss and victims tables and (2) mortgage fraud.

I. The Impact of the Loss Table and Victims Table in Calculating the Offense Level Should be Limited.

In Part D of the Dodd-Frank/Fraud proposed amendments, the Commission sets forth several options for limiting the impact of the loss table, victims table, or both because they "may overstate the culpability of certain offenders in cases sentenced under §2B1.1 that involve relatively large loss amounts."[1] We welcome meaningful efforts to reduce the impact of the loss and victim tables because they too often overstate the seriousness of the offense as well as the culpability of the offender, and do not serve the purpose of general or specific deterrence.[2]

A careful examination of the sentencing data for sentences imposed under §2B1.1 shows the guideline does a poor job of capturing offense seriousness or offender culpability. Only 55% of §2B1.1 sentences were within the range in FY 2011.[3] The rate of below-range sentences imposed under §2B1 is striking. The rate of non-government-sponsored below-range sentences was 23.5%.[4] That contrasts to an overall non-government-sponsored below-range rate of

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[1] USSC, *Proposed Amendments to the Sentencing Guidelines* 1 (2012) (reader friendly version).

[2] We have long contended that the emphasis on loss under the guidelines is a poor measure of culpability and that the Commission should revisit the original Commission's decision to structure the guidelines for economic crimes around loss

[3] USSC, *Preliminary Quarterly Data Report: 4th Quarter Release, Preliminary Fiscal Year 2011 Data Through October 31, 2011*, tbl. 5 (2011).

[4] *Id*.

17.2%.[5] The rate of government-sponsored below-range sentences was 19%.[6] Notwithstanding those below-range sentences, 78.8% of fraud offenders received sentences of imprisonment.[7]

When broken down to examine position within the guideline range for each of the loss adjustments, the FY 2010 data shows a dramatic decrease of within range sentences from the 6-level loss adjustment to the 30-level loss adjustment. In FY 2010, the majority of offenders falling within the 0-, 2-, and 4- level increases on the loss table were sentenced within the range – 86.9%, 80.7%, and 70%, respectively. *See* Addendum A. Offenders who received a 6-level adjustment or higher were sentenced within the range less than 50% of the time, and sometimes closer to 33% of the time. As to government-sponsored below-range sentences, those steadily increased from 3.2% to 50% as the loss table increased to level 26.[8]

As to non-government-sponsored below-range sentences, the data show an overall rate of 23%, with the fewest non-government-sponsored below-range sentences at levels 0, 2, and 4 of the loss table (6.7%, 11.8%, and 17.3% respectively), and the most non-government-sponsored below-range sentences at levels 6, 8, 10, 12, 26, and 30 (33.6%, 34.6%, 34.1%. 31.3%, 33.3%. 30.8%, respectively).

While other factors may influence the dramatic decline in the rates of within guideline sentences after the 4-level increase under the loss table, the data suggest that the loss table bears no meaningful connection to offense seriousness or offender culpability. Judges, as well as prosecutors, are finding that in many cases, §2B1.1 produces sentences that are too severe. The Commission should respond to this feedback by ameliorating the harsh effects of the upward ratcheting in §2B1.1 that has driven up sentences for non-violent offenders who typically present a low risk of recidivism. One way for the Commission to respond to this feedback and bring the guideline back in line with empirical evidence is to limit the impact of the loss and victims tables.

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[5] *Id.*, tbl. 1.

[6] *Id.*, tbl. 5.

[7] *Id.*, tbl. 18.

[8] At level 30, the government-sponsored below-range rate dropped back to 38.5%.

A. Current Loss Calculations Overstate the Seriousness of the Offense and Culpability of the Offender in Many Different Kinds of Fraud Cases.

1. History

The history of the fraud guideline is one of ever increasing severity, unsupported by empirical evidence. From the beginning of the guidelines, the Commission chose not to base the guidelines for economic crimes on past practice. Instead the Commission fashioned the guidelines so that fraud defendants would face harsher sentences than under pre-guidelines practice. Toward that end, and wanting to ensure a "short but definite period of confinement" instead of probation, the Commission identified loss as the most relevant factor at sentencing.[9] The original table called for graduated increases based upon loss with an11-level increase for losses over $5,000,000.

On November 1, 1989, the Commission increased the severity of the loss tables in the fraud and theft guidelines, ostensibly to "provide additional deterrence and better reflect the seriousness of the conduct." USSG, App. C, Amend. 154 (Nov. 1, 1989). That amendment added 7 more loss amount categories. A loss of more than $5 million jumped from 11 to 14. Losses more than $80,000,000 were at a level 20. The Commission provided no evidence that such increases were necessary to increase deterrence or to reflect the seriousness of the offense.[10]

The Commission in its November 1, 2001 amendment to the loss table "provided significantly increased penalties for offenses involving relatively moderate and *high loss amounts (generally exceeding $120,000)*." USSC, *Report to the Congress: Increased Penalties under the Sarbanes –Oxley Act of 2002* 7 (2003) (emphasis added) [hereinafter *Increased Penalties*]. The offense levels associated with certain loss amount categories were staggering. For example, the offense level for a fraud involving more than $200,000 jumped from 8 to 12. The offense level for a fraud involving $5 million jumped from 14 to 18. Whereas the 1998 fraud table was capped at 18, the 2001 table was capped at 26. USSG App. C, Amend 617 (Nov. 1, 2001).[11] The Commission promulgated these increases even though the available research showed that increasing sentences for fraud would not serve the purpose of deterrence.[12]

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[9] USSC, *Fifteen Years of Guidelines Sentencing: An Assessment of How Well the Federal Criminal Justice System is Achieving the Goals of Sentencing Reform* 55-58 (2004).

[10] *See*, *e.g.*, Jeffery S. Parker & Michael K. Block, *The Sentencing Commission, P.M. (Post-Mistretta): Sunshine or Sunset?*, 27 Am. Crim. L. Rev. 289, 318-20 (1989).

[11] The defense bar objected to those amendments, finding them unsupported by empirical evidence and unnecessary to serve the purposes of sentencing. *See* Statement of the Federal Public and Community Defenders on Proposed Amendments to the Sentencing Guidelines Published on January 26, 2001, at 28 (March 9, 2001); Comments of the New York Council of Defense Lawyers Regarding Proposed January

The loss table changed again in 2003 when the Commission, at the insistence of the Department of Justice, added two more loss amount categories to the table in response to the Sarbanes–Oxley Act of 2002, Pub. L. 107-204. Even though Sarbanes-Oxley was targeted at persons who engineered sophisticated and massive frauds by virtue of their corporate positions and even though the Commission had no time to assess the effect of the 2001 amendments, those changes applied to all fraud and theft offenses. USSG App. C, Amend. 647, 655 (Nov. 1, 2001). *See* USSC, *Public Hearing Minutes*.[13]

In short, the loss table alone, without even considering the many other specific offense characteristics added over the years, went from adding a maximum of 11 levels to a defendant's offense level in 1988 to a maximum of 30 levels today. Although the loss table is a cornerstone of §2B1.1, it should have less influence on the recommended guideline range than it does. In many cases, loss "is a kind of accident" and thus "a relatively weak indicator of the moral seriousness of the offense or the need for deterrence." *United States v. Emmenegger*, 329 F. Supp. 2d 416, 427 (S.D.N.Y. 2004).[14] Numerous courts recognize this flaw with the loss table. *See, e.g., United States v. Lauersen*, 362 F.3d 160, 164-65 (2d Cir. 2004), *vacated on other grounds*, 543 U.S. 1097 (2005); *United States v. Mueffelman*, 400 F. Supp. 2d 368, 372 (D. Mass. 2005) (same), *aff'd*, 470 F.3d 33 (1st Cir. 2006); *United States v. Watt*, 707 F. Supp. 2d 149, 155 (D. Mass. 2010) (sometimes loss is an effective "proxy for evaluating culpability," "sometimes it is not"); *United States v. Faulkenberry*, 759 F. Supp. 2d 915, 928 (S.D. Ohio 2010)) ("As has become common among district courts sentencing white-collar offenders in financial fraud cases, the Court finds that the loss calculation substantially overstates the gravity

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26, 2001 Amendments to the Sentencing Guidelines 3 (2001); Barry Boss and James Felman, Practitioner's Advisory Group, PAG's Submission on Proposed Amendments (March 16, 2001); Fred Warren Bennett, Practitioner's Advisory Group (March 9, 1998).

[12] U.S. Sent'g Comm'n, Symposium on Federal Sentencing Policy for Economic Crimes and New Technology Offenses *The Nature and Severity of Punishment for Economic Crimes: Determinants of Offense Seriousness and Offender Culpability*, 64-66, 69-70 (2000).

[13] http://www.ussc.gov/Legislative_and_Public_Affairs/Public_Hearings_and_Meetings/20030416/4_16_03.htm.

[14] *See also* Frank O. Bowman, III, *Sentencing High-Loss Corporate Insider Frauds After Booker*, 20 Fed. Sent. Rep. 167 (2008) ("[S]ince Booker, virtually every judge faced with a top-level corporate fraud defendant in a very large fraud has concluded that sentences called for by the Guidelines were too high. This near unanimity suggests that the judiciary sees a consistent disjunction between the sentences prescribed by the Guidelines [in these cases] and the fundamental requirement of Section 3553(a) that judges impose sentences 'sufficient, but not greater than necessary' to comply with its objectives."); Alan Ellis et al., *At a "Loss" for Justice: Federal Sentencing for Economic Offenses*, 25 Crim. Just. 34 (2011) ("While the fraud guideline focuses primarily on aggregate monetary loss and victimization, it fails to measure a host of other factors that may be important, and may be a basis for mitigating punishment, in a particular case.").

of the offense here and declines to impose a within-Guidelines sentence."), *aff'd*, __Fed. Appx. __ (6th Cir. Feb. 15, 2012).

2. Intended Loss

Intended loss[15] calculations, in combination with the relevant conduct rules,[16] can be particularly unfair, increasing loss amounts well beyond the actual loss or the culpability of the defendant. The guidelines use intended loss when it is greater than the actual loss. By definition, this means a loss that never happened. On top of the loss intended by the defendant, the relevant conduct guideline sweeps within the loss calculation the reasonably foreseeable intended loss of others in jointly undertaken activity. Thus, a defendant who subjectively intends a lesser amount of loss may be held accountable for a substantially greater amount intended by co-conspirators if that greater amount is reasonably foreseeable.[17]

Intended loss amounts may also be driven up by questionable inferences and special rules. For example, in some credit card and check fraud cases, courts calculate intended loss as the credit limit even if there is no evidence that the defendant consciously desired to maximize the loss by reaching a credit limit. *Compare United States v. Harris*, 597 F.3d 242, 259 (5th Cir. 2010) (district court did not err in calculating the defendant's intended loss as being equal to the credit limits of the credit cards compromised) with *United States v. Manatau*, 647 F.3d 1048, 1056–57 (10th Cir. 2011) ("a court cannot simply calculate 'intended loss' by totaling up credit limits without any finding that the defendant intended to inflict a loss reasonably approaching those limits"; intended loss means "a loss the defendant *purposely* sought to inflict").[18] Such a view is contrary to the definition of intended loss, which is the "pecuniary harm that was intended to result from the offense." USSG §2B1.1, comment. (n.3). The guidelines have "never endorsed sentencing based on the worse-case scenario potential loss," *United States v. Kopp*, 951 F.2d 521, 529 (3d Cir. 1991), but that is precisely what some courts do.

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[15] Intended loss" is the "pecuniary harm that was intended to result from the offense," including "harm that would have been impossible or unlikely to occur." USSG §2B1.1 cmt. (n.3(A)(ii)).

[16] In the case of fraud, the relevant conduct rules sweep so broadly as to include all acts and omissions that were "part of the same course of conduct or common scheme or plan as the offense of conviction." USSG §1B1.3(a)(2).

[17] *United States v. Sliman*, 449 F.3d 797, 803 (7th Cir. 2006) (defendant who subjectively intended loss amount of $4 million in counterfeit checks was held responsible for $26 million in intended loss).

[18] *See also United States v. Adetiloye*, 2012 WL 140408, *3 n.1. (D.N.D. Jan. 18, 2012) (noting the conflict but finding it unnecessary to resolve); *United States v. Mei*, 315 F.3d 788, 792 (7th Cir. 2003) (loss estimated based upon average credit card limit multiplied by number of cards used).

Similarly problematic are the rules on intended loss in cases where the "scheme could not possibly have resulted in the intended loss." *United States v. Galbraith*, 20 F.3d 1054, 1059 (10th Cir. 1994). Before 2001, some courts limited the intended loss to that which was possible. Those courts refused to sentence the defendant "on the basis of harm that he or she was incapable of inflicting." *United States v. Watkins*, 994 F.2d 1192, 1196 (9th Cir. 1993) (loss in check kiting scheme was the $13,100 defendant obtained, not the $42,600 face amount on the checks). The 2001 amendment changed that by including within the definition of intended loss "pecuniary harm that would have been impossible or unlikely to occur." USSG §2B1.1, comment. (n.3(A)(ii)). As a result, no matter how impossible or unlikely the loss, the defendant is responsible for the entire amount of the intended loss. The claimed rationale for the 2001 amendment was that including the entire amount of intended loss, even if impossible to occur, "better reflects the culpability of the offender." USSG App. C, Amend. 617 (Nov. 1, 2001).

Defenders respectfully disagree that the intended, yet impossible-to-obtain, loss amount is an accurate reflection of offender culpability. As one court explained: persons "who devise ridiculous schemes (1) do not ordinarily have the same mental state and (2) do not create the same risk of harm as those who devise cunning schemes. In short, they are not as dangerous. Thus, it is entirely proper to mitigate their sentences." *United States v. Roen*, 279 F. Supp. 2d 986, 991 (E.D. Wis. 2003). A "gross disparity between the actual loss and the intended loss" should also mitigate the harshness of the intended loss rule, *United States v. McBride*, 362 F.3d 360, 376 (6th Cir. 2004), but the guidelines encourage no such mitigation.

The "intended loss" concept has gotten so out-of-hand that the want-to-be thief with no chance of success is treated the same, or worse, than an actual thief. The person who "intends" a loss of $3 billion with an absurd scheme built upon sensational misrepresentations to a hedge fund about a phony Siberian oil pipeline and a long-lost Indian tribe, who caused no loss, and received no gain, should not be punished more harshly than a person who caused real victims to lose $10 million. Yet, that is precisely what is happening under the guidelines in some cases.[19]

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[19] *See United States v. Rodney Sampson*, No. 2:-6-cr-00264-SJF-3 (E.D.N.Y.).

3. Special Rules

Special rules on calculating loss can drive up loss calculations to levels that overstate the seriousness of the offense. The commentary to §2B1.1(3)(F) contains several special rules for calculating loss that have the effect of increasing loss amounts in ways that are disproportionate to the culpability of the defendant or the harm caused by the offense. For example, one of the rules requires the court to count the loss from every counterfeit or unauthorized access device as not less than $500, even though some credit cards have lower credit limits and the amount of the loss could have never reached $500.[20] Another rule that can grossly exaggerate loss is the one for federal health care offenses, which were discussed at length last year.[21]

Because the loss tables, intended loss, and special rules on calculating loss ratchet up sentences unnecessarily and often overstate the seriousness of the offense, the culpability of the offender, and the need to deter future criminal conduct, we support the Commission's efforts to explore ways in which the impact of the loss table can be limited. We believe the Commission's proposals are a good start, but also encourage it to consider amending the rules to further limit the impact of the loss and victims tables.

B. The Commission Should Limit the Impact of the Loss Table Where the Defendant Had Little Gain Relative to the Loss.

Defenders, along with others, have long advocated for a rule that lowers sentences for those defendants whose personal gain was substantially less than the loss amount. As early as 1994, the Third Circuit recognized that the loss table "may well overstate both the degree of [a defendant's] criminality and his need to be corrected," where the loss exceeded the defendant's gain. *United States v. Stuart*, 22 F.3d 76, 82 (3d Cir. 1994) (loss table called for 9-level enhancement for $129,000 loss, but defendant received only $2,000). Other courts have noted the same problem with the loss table. *See, e.g., United States v. Forchette*, 220 F. Supp. 2d 914, 925-31 (E.D. Wis. 2002) (departing downward where loss was $454,300, but gain was between $20,000 and 40,000).

In 2001, we encouraged the Commission to adopt a proposed downward departure provision where "the loss significantly exceeded the greater of the [defendant's] actual or intended [personal] gain, and therefore significantly overstates the culpability of the defendant." Statement of the Federal Public and Community Defenders on Proposed Amendments to the

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[20] Some companies offer credit cards with as little as a $300 credit limit. *See* http://www.creditcards.com/bad-credit.php.

[21] *See* Statement of Hector Dopico Before the U.S. Sentencing Comm'n, Washington, D.C., at 3 (Feb. 26, 2011).

Sentencing Guidelines Published on January 26, 2001, at 33 (March 9, 2011).[22] The Commission rejected the proposal after the Department of Justice objected.[23] In 2003, we encouraged the Commission to cap at 20 the cumulative offense level for less culpable defendants.[24] That was again rejected by the Commission.

Ten years later, the need for a mechanism to mitigate the impact of the loss table where the defendant's gain was relatively small persists. The fact remains that some defendants commit offenses to retain a job, to supplement a meager income and meet basic needs, or out of misguided loyalty.[25] Many of these defendants are unaware of the scope of the fraud and gain little or nothing from it. The guidelines, with sentences driven by the loss table, expose these defendants to sentences disproportionate to their culpability.[26]

Fortunately, some of these defendants receive judicial relief notwithstanding the guidelines. Take for example the case of Barbara Brown. Ms. Brown was a novice appraiser caught up in a mortgage fraud scheme with a total loss of over $4 million. She earned not a single penny as a result of her participation in the scheme. Ms. Brown, a first-time offender, faced a sentencing range of 63-78 months. The court, acknowledging "her extraordinary lack of profit" and "how the amount of loss grossly overstated her criminal conduct compared to that of the other defendants," sentenced her to 5 months imprisonment. *United States v. Hill*, 643 F.3d 807, 848 (11th Cir. 2011). John Hochrek, another appraiser involved in a mortgage fraud scheme received a similar below-guideline sentence. Although the loss amount resulted in an 18-level increase in the offense level, and the defendant faced a guideline range of 46-57 months, the court imposed a 6-month term of imprisonment. *United States v. Hochrek*, 2011 WL

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[22] *See also* Letter from Fred Bennett, Chair, Practitioner's Advisory Group, to the Honorable Richard P. Conaboy, Chair, U.S. Sentencing Comm'n, at 12 (March 5 ,1998).

[23] *See* Letter from Michael Horowitz, Chief of Staff, Criminal Division, Dep't of Justice, to the Honorable Diane E. Murphy, Chair, U.S. Sentencing Comm'n, at 12 (March 19, 2001).

[24] Comments of Federal & Community Defenders Before the U.S. Sentencing Comm'n, at 5 (Feb, 18, 2003).

[25] As one commentator put it: "There is a palpable difference in culpability between a defendant who commits bank fraud to obtain a loan he fully expects and desires to repay and a defendant who commits bank fraud for the sole purpose of running off with the money—and then does so. There is a difference in culpability between an employee who goes along with a fraud simply to keep his job and earn his ordinary salary and an employee who conceives and executes a fraud with the purpose of putting its proceeds into his pocket." James Felman, *The Need to Reform the Federal Sentencing Guidelines for High-Loss Economic Crimes*, 23 Fed. Sent. R. 138, 141 (2010).

[26] Mechanisms that might mitigate the harm, such as a reduction for minor or minimal role in the offense, "rarely compensate for the impact of a substantial loss," particularly if the defendant played a peripheral role in a larger conspiracy. *Watt*, 707 F. Supp. 2d at 155.

2601349, at *8 (E.D. Wis. June 30, 2011) (Sentencing Memorandum, Document 123). In imposing a below-guideline sentence, the court relied on a number of factors, including that the loss overstated the seriousness of the conduct and that the defendant gained nothing from the offense other than his normal realtor and appraisal fees. *Id*. at *3.[27]

Other defendants are not so lucky, receiving sentences grossly disproportionate to their offense conduct. We have represented numerous defendants who do nothing more than perform low-level functions in fraudulent schemes, such as serving as errand runners, recruiters, straw buyers, or "bird dogs,"[28] who receive little to no compensation, but who are saddled with huge amounts of loss, and receive no sentencing relief. We have also represented defendants who have been implicated in fraud by doing nothing more than their job and turning a blind eye to unlawful activities. These defendants gain nothing, but the guidelines hold them accountable for the full amount of loss.

While we applaud the Commission's desire to acknowledge that the gain to the defendant is relevant to fashioning an appropriate sentence, we think the Commission's proposal is too narrow. Under the proposal, the defendant's gain would have to be one percent or less than the maximum loss amount before the defendant could benefit from a cap. We have several concerns about the Commission's proposal. First, what is unclear from the Commission's proposal is whether the impact of the loss table for cases involving loss amounts below $400,000 would be subject to a similar rule. In other words, if a case involved a loss amount of $250,000, but only a gain of $500, would the defendant still be subject to an offense level 12? Second, the gain-to-loss ratio is arbitrary, inflexible, and does not capture how courts have seen the significance of gain. For example, in *Stuart*, 22 F.3d at 82 – a seminal case on how minimal gain can mitigate the impact of loss – the loss was $129,000 and the defendant's gain was $2,000 (1.5% of the loss). Under the Commission's proposal A, that defendant would receive no relief. Nor would the defendant in *Forchette* have gotten relief under the proposal. *Forchette*, 220 F. Supp. 2d at 925-31 (loss was $454,300, but gain was between $20,000 and $40,000).

In addition to capping the offense level where the defendant's gain is one percent or less than loss, the Commission should also consider a departure provision that would permit the court to take into consideration the defendant's gain, as well as other factors related to the defendant's participation in the offense, such as whether the defendant joined the scheme with the intent to

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[27] *See also id*. at 155 (loss not a good proxy for evaluating culpability because defendant "made nothing from the scheme"); *United States v. Keller*, 2005 WL 6192897, at *6 (N.D. Tex. 2005) (imposing below-guideline sentence in case where defendant received no monetary benefit from scheme [other than continued employment] to defraud).

[28] A bird dog is a person who alerts investors in an equity skimming scheme to properties that may be facing foreclosure.

make money or merely to hold a job; whether the defendant was aware of the full scope of the scheme; whether the defendant actively participated in making fraudulent misrepresentations or played some lesser function (like an errand runner or driver). An invited downward departure in cases where loss greatly exceeds gain would give courts greater flexibility in fashioning an appropriate sentence that accounts for the interplay between actual loss, intended loss, and gain.

C. The Commission Should Limit the Circumstances in Which the Victim Table Applies.

The Commission seeks comment on whether it should limit the impact of the victim table by providing that the 4-level and 6-level enhancements do not apply where the offense (1) did not substantially endanger the solvency or financial security of at least one victim or (2) when the enhancement under the loss table is [14]-[24] levels. We support both of these attempts to limit the impact of the victim table because the table is not necessary to accomplish the purposes of sentencing.

The original guidelines contained a 2-level adjustment, with a minimum offense level of 10 if the offense involved "a scheme to defraud more than one victim." USSG §2F1.1 (Nov. 1, 1987). This 2-level enhancement, like the one for "more than minimal planning," was meant to capture the fact that the crime was not an "isolated crime of opportunity" – an important consideration in pre-guidelines practice. *Id*. (backg'd). Significantly, it was not designed to account for financial harm to any victim.[29] The loss calculation was meant to reflect the harm to the victim. *See Watt*, 707 F. Supp. 2d at 155 (citing 1987 background commentary to §2B1.1, which stated, that "the value of property taken plays an important role in determining sentences for theft offenses, because it is an indicator of both the harm to the victim and the gain to the defendant.").

The economic crime package in 2001 added a 2-level enhancement for offenses involving ten but fewer than fifty victims and a 4-level increase for those involving fifty or more victims. USSG App. C, Amend. 617 (Nov. 1, 2001). Just two years later, the Commission expanded the victim table again as a result of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002). The Congressional directive giving rise to that amendment was directed at securities, pension, and accounting fraud. It instructed the Commission to "review and, as appropriate, amend" the guidelines. One of the considerations for the Commission was to

[29] "'Scheme to defraud more than one victim,' as used in subsection (b)(2)(B), refers to a design or plan to obtain something of value from more than one person. In this context, 'victim' refers to the person or entity from which the funds are to come directly. Thus, a wire fraud in which a single telephone call was made to three distinct individuals to get each of them to invest in a pyramid scheme would involve a scheme to defraud more than one victim, but passing a fraudulently endorsed check would not, even though the maker, payee and/or payor all might be considered victims for other purposes, such as restitution." USSG §2B1.1, comment. (n.3) (Nov. 1, 1987).

"ensure that the guideline offense levels and enhancements under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act), are sufficient for a fraud offense when the number of victims *adversely involved* is significantly greater than 50." *Id*. at §§ 905(a), 1104(b) (emphasis added). The Commission could have found it inappropriate to amend the victim table because no empirical evidence at the time indicated that sentences needed to be higher. It also could have narrowly tailored an amendment that captured the specific concerns Congress had with securities, pension, or accounting fraud. It could have even narrowly interpreted "adversely involved."

The Commission took no such targeted approach. Instead, the Commission expanded the sentencing enhancement at §2B1.1(b)(2) to require a 6-level enhancement for *all* fraud offenses involving 250 or more victims, and did not require a showing that the victims were adversely impacted. USSG App. C, Amend. 647 (Nov. 1, 2003). At the time, the Commission observed that the enhancement "will double the guideline sentence for any fraud, theft, or property destruction offense that impacts 250 or more victims, compared to the sentences for a comparable offender who impacts less than ten victims." *Increased Penalties*, at i. In addition, the Commission added an enhancement applicable to an offense that endangered the solvency or financial security of one hundred or more individuals. §2B1.1 (b)(15)(B)(iii). In the Commission's own words:

> The impact of these victim related enhancements is substantial. As a result of the amendment, offenders can be subjected to an increase of ten offense levels – approximately tripling the guideline sentence in many cases – based solely on these victim related harms.

Increased Penalties at ii.

Then, in 2009, the Commission responded to the Identity Theft Enforcement and Restitution Act of 2008, Title II of Pub. L. No.110-326, 122 Stat. 3560 (2009), by expanding the definition of "victim" to include "any individual whose means of identification was used unlawfully or without authority, even if those individuals suffered no loss and even if they were unaware that their identifying information had been obtained or misused." The Commission's actions significantly expanded the cases in which the 2-, 4- and 6-level increases would apply even though it had no data that lengthening the terms of imprisonment was necessary to serve the purposes of sentencing. USSG App. C, Amend. 736, Reason for Amendment (Nov. 1, 2009). *See generally* Statement of Jennifer Coffin Before the U.S. Sentencing Comm'n, Washington, D.C., at 7-10. (March 17, 2009).

The effect of all this ratcheting is that §2B1.1 is heavily weighted toward the pecuniary harm resulting to victims without being tied to specific purposes of sentencing. Pecuniary harm is a measure of offense seriousness, but it is counted twice under the guidelines. It is counted once in the loss table. It is counted again in the victim table. In fact, the victim table and loss table are so intertwined that to be counted as a victim, the individual or entity must sustain a pecuniary loss that is included in the loss calculation. *United States v. Miller*, 588 F.3d 560, 567-68 (8th Cir. 2009). Take for instance a simple investment scheme where the high loss amount is attributable to the fact that multiple persons invested small amounts of money over a course of years. But for the number of victims, the loss amount would have never increased. If married couples had invested, the number of victims would double. *See United States v. Densmore,* 21 Fed. Appx. 965, 971 (11th Cir. 2006).

The victim table overstates the seriousness of the offense and the culpability of offenders in other cases as well. Victims who were fully reimbursed by their banks, and who may have not even known about the fraud, are counted as victims for purposes of applying the victim table. *See United States v. States v. Stepanian,* 570 F.3d 51, 56 (1st Cir. 2009); United *States v. Panice*, 598 F.3d 426, 433 (7th Cir. 2010) (fact that account holder was reimbursed does not negate victim status).[30] Also counted are victims whose losses may have been counted toward the loss calculation, but who were otherwise made whole. *See United States v. Armstead*, 552 F.3d 769, 783 n.13 (9th Cir. 2008) ("Losses that are subsequently credited are still part of the initial loss calculation, and thus persons who suffered those losses are victims.").

The impact of the loss and victim tables is especially acute in credit card cases because the rules governing counterfeit credit cards and access devices inflate guideline ranges. Under the commentary, the loss on an access device, whether the device is used or not, is a minimum $500 per device. Many courts count the loss as the maximum credit limit on the card. On top of that, victims of identity theft who have suffered no monetary loss are counted under the victims table. USSG App. C, Amend. 726 (Nov. 1, 2009).[31] The cumulative impact of these rules can be sizable, even for a person who is nothing more than a middleman over a very short period of time and who gained little from the scheme. A recent case demonstrates the point. A man approached a tollbooth operator about making some extra money by swiping credit cards on a credit card skimmer. Over the course of a month, the operator swiped credit cards on the

[30] *But see United States v. Kennedy,* 554 F.3d 415, 419 (3d Cir. 2009) (account holders who were fully reimbursed were not "victims"); *United States v. Yagar*, 404 F.3d 967, 971 (6th Cir. 2005) (account holders who were reimbursed by banks suffered no adverse effect warranting application of victim enhancement).

[31] This latter rule was promulgated in 2009 after some courts had ruled that card holders who had been reimbursed promptly by their banks were not victims. *Cf. United States v. Mohammed*, 315 F. Supp. 2d 354, 361-63 (S.D.N.Y. 2003) (concluding, with the government's concession, that enhancement under §2B1.1(b)(2) was not proper where the defendant used stolen credit card information to make purchases and the victimized cardholders were reimbursed by the "merchants or financial institutions that ultimately bore the losses from these charges"); *Miller*, 588 F.3d at 568–69 ("victims" under §2B1.1 are only those who have sustained an "actual loss.").

skimmer, which recorded information found on the magnetic strips of the cards. When the man retrieved the skimmer, he gave the tollbooth operator $2,000. Shortly after the skimming started up again, the police arrested the tollbooth operator who then cooperated to apprehend the mastermind of the scheme. At sentencing, the tollbooth operator was held accountable for $2,649,287.25 in intended loss.[32] He also received a 4-level enhancement because the fraud involved more than fifty victims, *i.e.*, persons whose credit cards were swiped, but who may not have suffered any pecuniary harm. The defendant faced a guideline range of 78 to 97 months, well above the statutory maximum of 60 months under 18 U.S.C. § 371.

In short, the victim table is not narrowly tailored to account for a discrete harm suffered by victims and should be fixed. We believe the Commission's proposals to limit the impact of the victim table are a step in the right direction. We also encourage the Commission to limit the impact of the victim table by narrowing the definition of victim to those who truly suffer long-term pecuniary harm.

D. Other Possible Ways to Ameliorate the Impacts of the Loss and Victim Tables

In the past, the Commission has considered a variety of proposals that would serve to lessen the impact of the loss and victims tables. We encourage the Commission to take another look at those proposals as part of its review of the fraud guideline.[33] It also would be beneficial to closely examine the multitude of reasons that courts have given for departing from the guidelines in cases where the loss amount significantly overstated the seriousness of the defendant's conduct. These cases would help inform decisions about how best to revise the definitions of loss, recalibrating the loss table, or adding language that better elaborates on the generic departure language currently in the guideline at §2B1.1, comment. (n.19(D)).[34]

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[32] "This figure was calculated by adding $2,545,287.25, the aggregate credit limit for the 339 credit cards of which the credit limits were known, to $104,000.00, which represented a $500.00 loss for each of the 208 cards for which the credit limits were not known." *Harris*, 597 F.3d at 248.

[33] *See* Notices, United States Sentencing Commission, Sentencing Guidelines 63 Fed. Reg. 601-02, 620 (Jan. 6, 1998) (inviting comment on downward departure or specific offense characteristic where loss amount is "far in excess of the benefit personally derived (or intended) by the defendant); Notices, United States Sentencing Commission, Sentencing Guidelines, 66 Fed. Reg. 7962-01, 7883 (Jan. 26, 2001) (proposing departure where loss exceeds defendant's intended or personal gain); *id*. (seeking comment on downward departure where "primary objective of the offense was a mitigating, non-monetary objective); Notices, United States Sentencing Commission, Sentencing Guidelines, 62 Fed. Reg. 44674-01, 44700 Jan. 2, 1997) (proposing downward departure for variety of situations where loss overstates seriousness of offense, including where misrepresentation is not sole cause of loss or was of limited materiality).

[34] *See McBride*, 362 F.3d at 375 (noting that "Commission has provided no further guidance regarding the application of the downward departure provision in §2B1.1).

One of many such cases is *Forchette*, 220 F. Supp. 2d at 923-25. *Forchette* outlines a variety of factors that courts have deemed relevant in deciding whether to depart on the basis that the fraud guideline overstates the seriousness of the defendant's conduct. These factors include the following: whether factors beyond the defendant's control (e.g. market forces, economic downturn, negligence by victims) contributed to the amount of loss; whether the intended loss was improbable; the defendant's knowledge of the amount being taken; the defendant's intent in joining a scheme to defraud; the materiality of any misrepresentations made; the defendant's personal gain in comparison to the size of the loss; and the defendant's efforts to remedy a wrong.

We also encourage the Commission to examine other ways in which it may limit the cumulative adjustments for similar harms. Here are a few examples that might be considered.

- **Provide for a mitigating role cap and encourage more use of the adjustment for mitigating role.** Section 2D1.1(a)(5) provides a cap on the drug quantity table for persons who receive a mitigating role adjustment. A similar adjustment would be appropriate for §2B1.1, along with an amendment to the commentary to §3B1.2, comment. (n.3(A)) so that it encourages application of the adjustment in cases where the loss amount greatly exceeds the defendant's gain and the defendant had limited knowledge of the scope of the scheme. The note currently advises that application of a mitigating role adjustment in such a situation is "not precluded." We think more affirmative language would help ensure application of the role adjustment. For example, the Commission could strike "is not precluded from consideration" and replace it with "should generally be considered." The Commission could also make clear that the example it provided for nominee owners is only one of many situations where an adjustment might be in order.

- **Limit the impact of the intended loss rule.** Aside from narrowing the use of intended loss as discussed earlier, one ameliorative fix would be to provide a series of examples alongside the downward departure language in the commentary at §2B1.1(19)(C) (inviting departure in "cases in which the offense level determined under the guidelines substantially overstates the seriousness of the offense"). Section 2F1.1, comment. (n.11) (2000) previously provided as an example a case where a "defendant attempts to pass a negotiable instrument so obviously fraudulent that no one would seriously consider honoring it." Another example would be where the intended loss greatly exceeded the actual loss.

- **Cap the many cumulative adjustments set forth in §2B1.1(b)(3) – (18).** Other guidelines contain caps designed to avoid disproportionate cumulative adjustments. These guidelines with caps include the robbery and extortion guidelines, where the cumulative adjustment that may be imposed for use of a weapon and for victim injury may not exceed 11 levels. *See* USSG §2B3.1(b)(2) &(3); USSG §2B3.2(b)(4).

- **Craft a safety-valve for fraud cases**. The Commission crafted the safety valve to mitigate the harsh effects of using drug quantity as the measure of culpability in drug case. The Commission could likewise amend the guidelines to better account for the mitigating factors present in fraud cases. Such a "safety-valve" could apply to low-level defendants who disclose to the government the names of other participants of the scheme in exchange for a reduction in their offense level.

These are just a few proposals for the Commission to contemplate as it reviews the fraud guideline. There are undoubtedly many more. We think it important to carefully consider curbing the excessive sentences that §2B1.1 often produces. Section 2B1.1 produces guideline sentences that are unjust and unfair, violate 18 U.S.C. § 3553(a), and decrease confidence in the criminal justice system and the guidelines. They too often create "unwarranted similarities" among dissimilarly situated individuals. *See Gall v. United States*, 552 U.S. 38, 55-56 (2008). Individuals convicted of fraud offenses vary greatly in their motivation for committing the offense, the role they placed, the gain they received, their knowledge of the scheme, and the loss they truly intended. Lengthy prison sentences for all of these individuals are unnecessary to accomplish the purposes of sentencing and undermine respect for the criminal justice system.

Aside from the fact that §2B1.1 often overstates the seriousness of the offense and the culpability of the offender, significant justification for limiting the impact of the loss and victim tables is that the assumptions about deterrence that drove the guidelines up for so many years have been proven untrue.[35] It is in the certainty of punishment, not its severity, that deterrent power lies.[36] A 2010 review of deterrence research concluded that there is "no real evidence of a deterrent effect for severity."[37]

[35] When the Commission increased the initial fraud guidelines beyond what was typically imposed in past practice, it explained that "the definite prospect of prison, though the term is short, will act as a significant deterrent to many of these crimes, particularly when compared with the status quo where probation, not prison, is the norm." USSG, ch. 1, intro., pt. 4(d) (1987); *see also* U.S. Sent'g Comm'n, *Fifteen Years of Guidelines Sentencing: An Assessment of How Well the Federal Criminal Justice System is Achieving the Goals of Sentencing Reform* 56 (2004) (Commission sought to ensure that white collar offenders faced "short but definite period[s] of confinement").

[36] *See* Steven N. Durlauf & Daniel S. Nagin, *Imprisonment and Crime: Can Both be Reduced?,* 10 Criminology & Pub. Pol'y 13, 37 (2011) ("The key empirical conclusions of our literature review are that at prevailing levels of certainty and severity, relatively little reliable evidence of variation in the severity of punishment having a substantial deterrent effect is available and that relatively strong evidence indicates that variation in the certainty of punishment has a large deterrent effect, particularly from the

Not only has the "myth of deterrence" been shattered by empirical research, the empirical research shows that lengthy prison sentences are not an effective method for reducing recidivism. Moreover, a "significant portion of the evidence points in the opposite direction – such sanctions may increase the likelihood of recidivism."[38] Judge Roger Warren echoed the same point in 2007: "The research evidence is unequivocal that incarceration does not reduce offender recidivism."[39] Instead, "[i]incarceration actually results in slightly increased rates of offender recidivism."[40]

As the expert body charged by Congress with establishing sentencing policies and practices that "reflect, to the extent practicable, advancement in knowledge of human behavior as it relates to the criminal justice process," 28 U.S.C. § 994(b)(1)C), the Commission should resist perpetuating the erroneous assumption that increasing sentence severity will deter crime.

Whatever mitigating adjustments, caps, or other limits the Commission chooses to promulgate should apply to all offenses and all guidelines dependent upon the loss table. This would be in keeping with the Commission's past decision to maintain proportional relationships. *See generally Increased Penalties*, at 6.

II. Mortgage Fraud

The Commission's two proposed changes to the mortgage fraud guidelines may initially appear to be small clarifications, but they would have the unintended consequence of creating further confusion and complexity. Defenders stand ready to work with the Commission on simplifying the fraud guideline, but we oppose both of the proposed mortgage fraud amendments because they move in the opposite direction.

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vantage point of specific programs that alter the use of police."), http://onlinelibrary.wiley.com/doi/10.1111/j.1745-9133.2010.00680.x/pdf

[37] Raymond Pasternoster, *How Much Do We Really Know About Criminal Deterrence*, 100 J. Crim. L. & Criminology 765, 818 (2010). "[I]n virtually every deterrence study to date, the perceived certainty of punishment was more important than the perceived severity." *Id.* at 817.

[38] Mark W. Lipsey and Francis T. Cullen, *The Effectiveness of Correctional Rehabilitation: A Review of Systematic Reviews*, 3 Ann. Rev. L. Soc. Sci. 297, 302 (2007), http://cjjr.georgetown.edu/pdfs/ebp/lipsey_cullen2007.pdf.

[39] Roger Warren, National Center for State Courts, *Evidence-Based Practice to Reduce Recidivism: Implications for State Judiciaries* (2007), http://nicic.gov/library/files/023358.pdf.

[40] *Id*. A recent Missouri study shows "that recidivism rates actually are lower when offenders are sentenced to probation, regardless of whether the offenders have prior felony convictions or prior prison incarcerations." Missouri Sentencing Advisory Commission, *Probation Works for Nonviolent Offenders*, 1 Smart Sentencing 1 (June 2009), http://www.courts mo.gov/file.jsp?id=45429. On a three-year follow up from the start of probation or release from prison, first or second-time offenders on probation were incarcerated at a significantly lower rate (36%) than those who had been sent to prison (55%). *Id*.

A. Foreclosure Sale

The Commission has proposed creating a special rule to address how to calculate credits against loss "[i]n the case of a fraud involving a mortgage loan in which the collateral has been disposed of at a foreclosure sale." In its issue for comment, the Commission also queries whether there should be "an additional special rule for determining fair market value if the mortgaged property has not been disposed of by the time of sentencing." We oppose the creation of these special rules, which would lead to the proliferation of even more special rules, and unnecessarily add confusion and complexity to the fraud guideline. The current, more general rule provides greater clarity and necessary flexibility in light of the various scenarios that arise in these cases.[41]

Once there is a special rule that singles out how to handle a particular situation, there will be increased confusion and litigation about what that special rule means for the myriad of other situations where there is collateral that needs to be credited against loss. For example, once foreclosure sale is singled out, it raises more questions about the appropriate measure of the fair market value for collateral where there was no foreclosure. Sometimes lenders obtain rights to the property not by foreclosing, but by obtaining a deed in lieu of foreclosure.[42] To dispose of property, in addition to foreclosure, lenders use short-sales and real estate owned (REO) sales. With a short-sale, the lender "agrees to sell a home for less than is owed on the mortgage."[43] With an REO, the property is disposed of after the "bank or other entity . . . has taken ownership of the home."[44]

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[41] Under the current rule, district courts take a "realistic economic approach" to determining loss. *United States v. Crandall*, 525 F.3d 907, 914-15 (9th Cir. 2008) (reviewing variety of methods by which district court might "estimate lass from the real estate fraud," including fair market value appraisals, tax assessor valuations, or estimates of the defendant's gain as contemplated by USSG §2B1,1 comment. (n.3(B))).

[42] "A deed in lieu of foreclosure involves the tender of the subject property deed back to the lender." Rebecca A. Taylor, *Foreclosure Defense, A Practical Litigation Guide* 62, ABA (2011). *See* Paul E. Roberts, *Deeds in Lieu of Foreclosure*, ALI-ABA Course of Study (Jul. 17, 1989) ("Because of the delays and problems inherent in foreclosures and bankruptcy proceedings, lenders have found that acceptance of a deed in lieu of foreclosure may, in appropriate circumstances, be the most desirable alternative.").

[43] Tara Siegel Bernard, *Foreclosures Can Offer Deals, but Buyer Beware*, New York Times (Dec. 4, 2009), http://www.nytimes.com/2009/12/05/your-money/mortgages/05money.html. A short sale permits the lender to write off the loss and avoid having to manage the property while it remains on the market. *See* Noam Scheiber, *Inside the Upside-Down World of the Short Sale*, New York Times (Sept. 9, 2007) (explaining incentives for lenders to approve short sales).

[44] Tara Siegel Bernard, *Foreclosures Can Offer Deals, but Buyer Beware*, New York Times (Dec. 4, 2009), http://www.nytimes.com/2009/12/05/your-money/mortgages/05money.html.

In today's market, REO sales – not foreclosures – are the most common way of disposing of property, according to experts we consulted in the field. One author estimates that "more than 98 percent of the houses that are foreclosed in a down market are purchased by the lender at a foreclosure sale."[45] That is because at foreclosure auctions, the lender sets the initial bid at "the balance of the loan that's in foreclosure plus any interest and penalties."[46] "If no one bids above that amount, the foreclosing lender will take possession of the property."[47] In the current market, it is the exception to the rule that someone walks into a foreclosure sale, prepared to pay cash – as is often required – where the initial bid, set by the lender, is often higher than the fair market value.[48]

Singling out foreclosure "sale" is even more complicated because foreclosure law varies from state to state and, depending on the state, there may not be an auction sale. There are fifty different sets of laws governing foreclosure.[49] In most states, using either judicial or nonjudicial foreclosure, there is a sale of the property as the final step in the foreclosure process. But not all states follow this process. Connecticut and Vermont both allow "strict foreclosure," where "a judge who approves the foreclosure can order ownership (title) to be transferred then and there."[50] In addition, in Louisiana, foreclosure can occur through an executory process. Under this system, "the homeowner has three days to come up with the money they owe after receiving a Notice of Default by the bank. If they do not, then the property is considered foreclosed and given back to the lender."[51]

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[45] James I. Wiedemer, *The Homeowner's Guide to Foreclosure* 95 (2d ed. 2008).

[46] Ralph R. Roberts, *Foreclosure Investing for Dummies* 178 (2007).

[47] RealtyTrac, *How to Buy a Home at Auction*, http://www.realtytrac.com/foreclosure/Auction/how-to-buy-homes-at-auction.html.

[48] "In a typical fraudulent mortgage scheme, a credit bid" made by the lender for an amount that "cancel[s] the outstanding principal, interest and related fees in return for title to the property" is "highly likely to overvalue the property." *United States v. Green*, 648 F.3d 569, 584 (7th Cir. 2011).

[49] *See* http://www.realtytrac.com/foreclosure-laws/foreclosure-laws-comparison.asp.

[50] Stephen Elias, *The Foreclosure Survival Guide*, http://www.nolo.com/legal-encyclopedia/free-books/foreclosure-book/chapter2-3.html.

[51] Frankie Orlando, *The Pre-Foreclosure Real Estate Handbook* 40 (2006); *see also* http://www.realtytrac.com/foreclosure-laws/Louisiana-Foreclosure-Laws.asp. Another method, "foreclosure by possession," not sale, remains a legal possibility at least in New Hampshire, even if not used "very often or ever." This procedure "lets the lender take possession of a house by 'peaceful entry.'" Stephen Elias, *The Foreclosure Survival Guide*, http://www.nolo.com/legal-encyclopedia/free-books/foreclosure-book/chapter2-3.html; *see also* National Law Center on Homelessness and Poverty,

Another problem with amending the guidelines to point specifically to foreclosure sale is that it is not a reflection of the fair market value and likely either undervalues the property or overvalues it depending on the market and other circumstances. For example, at least one court has noted that in the current market, using the winning bid at a foreclosure auction often will mean using a figure that is above the market value for that property, resulting in a credit against loss that is too high, and a loss figure that is too low. The court explained that under the common scenario, where the auction leads to the lender acquiring the property through a "bid" that offers to cancel the outstanding principal, interest, and related fees, that bid is "not a reliable measure of the actual market value of the property."[52] This bid "is highly likely to overvalue the property" and using this bid "to measure loss would surely understate the actual loss."[53]

On the other hand, a foreclosure sale can also result in a sale that is below the fair market value of the collateral. Foreclosure sales lack the benefit of full competition and thus the winning bid at a foreclosure auction can be artificially low.[54] For example, "prospective buyers other than the mortgagee must bid in cash; the sales are not well publicized; and prospective buyers have no real opportunity to inspect the property."[55] "As a result, the mortgage company is often the high bidder at a price well below the actual value of the property."[56]

Finally, the current foreclosure crisis highlights the peril in general of attempting to single out one specific method of determining the fair market value of collateral, and in particular of relying on foreclosure as that method. The "robo-signing" scandal has brought to light the regular use of forged documents on behalf of lenders in foreclosure proceedings.[57] As a

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Without Just Cause: A 50-State Review of the (lack of) Rights of Tenants in Foreclosure 73 (Feb. 25, 2009), http://nlchp.org/content/pubs/Without_Just_Cause1.pdf.

[52] *Green*, 648 F.3d at 584; *see also United States v. Judy Yeung*, __ F.3d __, 2012 WL 432289, at *7 (9th Cir. Feb. 13, 2012) ("A lender's credit bid may not reflect the value of the collateral in all circumstances.").

[53] *Id.*

[54] Joshua R. Hendrickson, Comment, *Take the Home but Spare the Equity: A Proposal to Bifurcate the Foreclosure Process*, 40 McGeorge L. Rev. 777, 788 (2009).

[55] *Id.*

[56] *Id.* at 789. *See also* Daniel Indiviglio, *Chart of the Day: Foreclosure Sale Discount by State*, The Atlantic (May 26, 2011), http://www.theatlantic.com/business/archive/2011/05/chart-of-the-day-foreclosure-sale-discount-by-state/239517/ (noting imperfect market may explain why the foreclosure discount rate varies from state to state; sales may be more competitive in places where people are well aware of large number of foreclosures, and less competitive in markets where fewer foreclosures).

[57] *See* Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* [hereinafter "Financial Crisis Inquiry Report"]

federal bankruptcy judge stated recently in open court, the failure of the mortgage industry to deal with pervasive problems involving inaccurate documentation and improper court filings amounts to "the greatest failure of lawyering in the last 50 years."[58] Just five banks have already agreed to pay or write down $26 billion for foreclosure abuses under a settlement that does not release them from further liability.[59]

For all of these reasons, we encourage the Commission not to add special rules to the current explanation of credits against loss. Amending the commentary to add special rules for foreclosure sales, or any of the other myriad of circumstances that arise in these cases will only create more complexity and confusion and does not further serve the purposes of sentencing.

B. Costs

The Commission proposes another special rule to add to the loss amount "the reasonably foreseeable administrative costs to the lending institution associated with foreclosing on the mortgaged property." Defenders oppose this amendment. Without offering any improvement in the measure of the seriousness of the offense or the culpability of the offender, the proposed amendment would put the determination of the loss amount in the hands of third parties, and unnecessarily introduce additional complexity and confusion, as well as unwarranted disparity.

This special rule for mortgage fraud is in tension with other language in the Commentary directing that "loss shall not include the following: Interest of any kind, finance charges, late fees, penalties, amounts based on an agreed upon return or rate of return, or other similar costs."[60] The proposed amendment, by singling out foreclosure costs as an amount to be *included* in the loss would treat loss for mortgage fraud differently than loss for any other kind of fraud. There is no empirical evidence to support this distinction.

407-08 (2011) (describing problems such as forged signatures, backdating, and retroactive assignments of notes "in an effort to clean up the paperwork problems from earlier years"). The Government Printing Office's edition of the Financial Crisis Inquiry Report is available at http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf. The term "robo-signing" was coined in reference to lenders' and loan servicers' common practice of having affidavits signed by persons who had not reviewed the facts attested therein. One "'robo-signer,' Jeffrey Stephan of GMAC, said that he signed 10,000 affidavits in a month—roughly 1 per minute, in a 40-hour workweek—making it highly unlikely that he verified payment histories in each individual case of foreclosure." *Financial Crisis Inquiry Report* 407.

[58] *See* Gretchen Morgenson, *A Mortgage Tornado Warning, Unheeded*, New York Times (Feb. 4, 2012) (quoting the Hon. Robert D. Drain of the Southern District of New York).

[59] *See* Brady Dennis & Sari Horwitz, *Settlement Launches Foreclosure Reckoning*, Washington Post (Feb. 10, 2012).

[60] USSG §1B1.1, comment. (n.3(D)(i)).

The reasons that these costs are generally excludable from the loss calculation are as applicable to mortgage fraud as to any other form of fraud. The Commission determined that the exclusion of these costs "is consistent with the general purpose of the loss determination to serve as a rough measurement of the seriousness of the offense and culpability of the offender and avoids unnecessary litigation regarding the amount of interest to be included."[61] Relying on "reasonably foreseeable" foreclosure costs does not advance the goal of using loss as a "rough measurement" of offense seriousness or offender culpability, and there would be extensive litigation over the application of the proposed language.

The relative uselessness of this proposed amendment in assessing culpability and offense seriousness is evident from the fact that foreclosure costs vary from state to state depending on the laws in place at the time. In Connecticut or Vermont where strict foreclosure is available, the costs will be much lower[62] than in Florida where judicial foreclosure is the only option.[63] That the offense occurred in Florida instead of Connecticut does not make it worse, or the defendant more culpable simply because the cost to the lender was higher in one place.[64] Certainly the lender in Florida is in a worse position than it might have been in Connecticut, but that problem is best addressed through restitution, where reasonable costs of foreclosure are recoverable.[65]

Addressing these costs at restitution, rather than at sentencing, also solves the problem that foreclosure is not the only method by which banks address loans that are in default. As discussed above, lenders also use short sales and deeds in lieu of foreclosure to deal with mortgages in default. If costs are left to be addressed where they belong – at restitution – then

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[61] USSG App. C, Amend. 617 (Nov. 1, 2003).

[62] "Strict foreclosure is the most economically efficient method of foreclosure, as it does not involve a forced sale of the property." Joshua R. Hendrickson, Comment, *Take the Home but Spare the Equity: A Proposal to Bifurcate the Foreclosure Process*, 40 McGeorge L. Rev. 777, 785 (2009).

[63] http://www.realtytrac.com/foreclosure-laws/Florida-Foreclosure-Laws.asp.

[64] This also raises the question of how a court would determine what costs are reasonably foreseeable given that there can be significant variance depending on whether the state uses judicial foreclosure non-judicial foreclosure or strict foreclosure. Would the determination involve assessment of what costs are reasonable in the state where the property is located? What about where there are multiple properties in different states?

[65] Under the Mandatory Victims Restitution Act (MVRA), 18 U.S.C. § 366A, the "basic rule is that the victim is entitled to be made whole." *Judy Yeung*, 2012 WL 432289, at *4. "Because restitution should address a victim's 'actual losses,' we have approved restitution awards that included . . . prejudgment interest . . . interest still due on the load, and expenses associated with holding the real estate collateral that were incurred by the lender before it took title to the property." *Id.* at *5 (internal citations omitted). *See also United States v. Bryant*, 139 F.3d 893 (4th Cir. 1998) (affirming a district court's restitution order which included attorneys' fees and foreclosure costs).

courts will not have to answer the impossible question the proposed amendment raises: whether it is reasonably foreseeable a property will be sold through foreclosure rather than in a short sale. Instead, at the restitution stage, the court can focus on the more manageable task of determining whether there actually was a foreclosure instead of a short sale, and what the lender lost in the process.

Extensive litigation would be necessary to sort out the meaning of several different provisions of the proposed amendment in each and every case. For example, courts would have to decide exactly which "administrative costs" are reasonably foreseeable. On the macro level, are any administrative costs of foreclosure reasonably foreseeable if the fraud occurred when the market was on its seemingly unending climb up? The market collapse that occurred – and the resulting foreclosures – was of a scale no more foreseeable to persons engaged in mortgage fraud than it was to the many investors who poured funds into the real estate market before the bubble burst. On the micro level, even if courts determine foreclosure was foreseeable, there will be much debate about which specific costs were reasonably foreseeable, from auction costs to lawn maintenance costs that the lender might incur as part of its efforts to maintain and sell the property. It is also unclear whether the Commission intends the administrative costs to include loan initiation costs that would have occurred regardless of whether there was a fraud, or only costs on the back end, once foreclosure proceedings have begun.

Indeed, at this stage in the mortgage fiasco, the concept of "administrative costs" might well become a euphemism for highly questionable banking practices that are no tether for reasonable estimates of loss. Consider "force-placed insurance," or hazard insurance secured on behalf of lenders in the event of a lapse in coverage under a homeowner's policy. This substitute coverage has frequently been obtained from lenders' own affiliates at inflated prices, with the premiums passed along to homeowners.[66] Should a homeowner subsequently default and cease paying the force-placed insurance premiums, would these premiums become an "administrative cost" even though they represent a sum recouped by the lender's own affiliate?

In addition to litigation about "administrative costs," parties would also litigate the issue of whether the lending institution "exercised due diligence." This is a fact intensive, case specific question that would have to be assessed in each and every case.

Finally, it is unclear how this proposed amendment to include foreclosure costs in the loss calculation would interact with the proposal to use "the amount recovered from a foreclosure sale" in credits against loss. If "amount recovered" in the proposed addition to application note 3(E)(ii) is interpreted to mean the net amount (sale price less costs), it would result in

[66] *See* Gretchen Morgenson, *Hazard Insurance with Its Own Perils*, New York Times (Jan. 21, 2012).

inappropriate double counting if costs are also added to the loss amount in application note 3(D)(iv).

C. Mitigating Factors

In its Issues for Comment, the Commission asks whether there are "mitigating factors in cases involving mortgage fraud or financial fraud that are not adequately accounted for in the guidelines" and if so, how the Commission should "account for those mitigating factors." Above, we addressed a number of mitigating factors and ways the guidelines could account for those. Here we address mitigating factors more narrowly tailored to the situations that arise in mortgage fraud cases.

Many of the mitigating factors in mortgage fraud cases are circumstances that should reduce the loss amount, which is the primary culprit in unduly severe guideline ranges. These factors could be accounted for in the guidelines either by changes to the loss definition, or through invited departures. For example, one such factor that is not adequately addressed by the guidelines is that in many cases involving real estate transactions, the lender who ultimately disposes of the collateral is not the original victim of the offense conduct, and it may be that this secondary lender purchased the loan from the original lender at a reduced rate and/or earned income from servicing the loan, and/or earned income from the loan on the secondary investment market. Under these circumstances, the actual loss to the lender can be significantly less than what the guidelines indicate.

Another such factor is a significant and widely-unanticipated fluctuation in the real estate market that results in the unpredictable undervaluation of collateral. Where loss is driven by such circumstances, instead of defendant design, a reduction is in order.

It is also a mitigating factor when the defendant's gain is minimal. In mortgage fraud cases, our clients too often are brokers, appraisers, and closing agents who only received a small fee in connection with the fraudulent loan, but under the current guideline are held accountable for a loss amount far higher than anything they received or intended to receive.

III. Conclusion

In closing, the empirical evidence shows that in a great many cases, USSG §2B1.1 does not reliably capture the seriousness of the offense or the culpability of the offender. The guideline would better serve the purposes of sentencing if it focused on the real pecuniary harm done to victims, the gains reaped by defendants, the defendant's motive in committing the offense, and other factors relevant to the defendant's culpability. We think it a grave mistake for the Commission to add special loss calculation rules in mortgage fraud cases because they are unnecessary and will only add complexity to an already intricate guideline. The Commission would do well to focus on ways to limit the impact of the loss and victim tables to better bring the guideline in line with sentencing practice. Because §2B1.1 is so complex, we encourage the Commission to continue its review of this guideline, and we look forward to working with the Commission in this endeavor.

ADDENDUM

Position of Sentences Relative to the Guideline Range for FY2010 2B1.1 Offenders With Full Information
Tabulated by Adjustment for Loss SOC (b)(1)

	None	2	4	6	8	10	12	14	16	18	20	22	24	26	28	30	Total
Within	1331	418	820	522	300	242	251	315	184	127	63	24	7	1	0	4	4609
	86.9%	80.7%	70.0%	47.1%	41.6%	36.8%	38.1%	40.9%	39.0%	39.9%	43.2%	41.4%	35.0%	16.7%	.0%	30.8%	56.4%
Above	50	10	31	22	25	18	16	18	12	7	1	2	0	0	0	0	212
	3.3%	1.9%	2.6%	2.0%	3.5%	2.7%	2.4%	2.3%	2.5%	2.2%	.7%	3.4%	.0%	.0%	.0%	.0%	2.6%
Gov	49	29	117	192	147	173	185	221	146	104	48	20	10	3	0	5	1450
Spons	3.2%	5.6%	10.0%	17.3%	20.4%	26.3%	28.1%	28.7%	30.9%	32.7%	32.9%	34.5%	50.0%	50.0%	.0%	38.5%	17.7%
Other	102	61	203	372	250	224	206	216	130	80	34	12	3	2	2	4	1903
Below	6.7%	11.8%	17.3%	33.6%	34.6%	34.1%	31.3%	28.1%	27.5%	25.2%	23.3%	20.7%	15.0%	33.3%	100.0%	30.8%	23.3%
Total	1532	518	1171	1108	722	657	658	770	472	318	146	58	20	6	2	13	8174
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%