"Intended Loss" Redefined in Fraud Cases

BY ALAN ELLIS AND JAMES H. FELDMAN, JR.

Although the sentencing guidelines have been "advisory" for more than four years, *see United States v. Booker*, 543 U.S. 220 (2005), they remain central to the federal sentencing process, since they are a court's "starting point and the initial benchmark" for determining a sentence. (*See* Gall v. United States, 128 S. Ct. 586, 596 (2007).) In fraud cases, the most important factor in determining the guideline offense level is the loss suffered by the victims. Since the "loss" for purposes of the guidelines is the higher of the intended or actual loss, what constitutes "intended" loss can be critical. (*See* U.S.S.G. § 2B1.1, Appl. Note 3(A) (Nov. 1, 2008, ed.); U.S.S.G. 2F1.1, Appl. Note 7 (Nov. 1, 1997, ed.).) In 2008, the Second Circuit established a principle affecting the determination of intended loss in a major financial fraud case that may prove to be important to defendants charged with crimes growing out of the financial collapse. For the first time, the Second Circuit made it clear that "intended loss" means just what it says—the loss actually intended by the defendant—not the potential or possible loss.

United States v. Confredo, 528 F.3d 143 (2d Cir. 2008) (the authors represented the appellant), involved the owner of a financial services company who helped failing businesses obtain loans by falsifying financial information on loan applications to make the businesses appear credit worthy. Over the course of three years, Gary Confredo helped his customers submit more than 100 applications for loans totaling more than $24 million. Even though Confredo used his experience as a former bank loan officer to put together loan applications he knew would have a good chance of being approved, only about half the loans were actually granted. At the time the fraud was discovered, the actual loss to the banks was a little more than $10 million.

The question before the court was what constitutes "intended" loss. Although Confredo never personally intended to make any loan payments, his clients had repaid at least $1.5 million in principle by the time the fraud was discovered. The prosecution nevertheless argued in the district court that the intended loss was more than $20 million requested in the loan applications. The defense argued that there were two reasons why the loss was more than $10 million but less than $20 million. First, the defense argued that as a former bank loan officer, Confredo knew that no matter how credit worthy the phony applications made his clients appear, the banks would deny a number of the claims outright and fund others at lower amounts. He also knew that this was true from his experience in submitting the more than 100 loan applications over a three-year period. Second, the defense argued that Confredo expected at least some of his clients to make payments on the loans. It was in Confredo's interest to select clients who could and would make as many payments on the loans as they could, since the longer the fraud went undetected, the more money Confredo could make. The district court judge, Leonard Sand, Sr., accepted the prosecution's arguments and ruled that the amount of loans applied for was the intended loss, because:

> Confredo is not a borrower who used fraud to obtain a loan which he then paid back in full. Confredo secured loans for dozens of entities and he retained no control whether those loans were paid off, nor did his remuneration change depending on whether the borrowers paid any of the funds back.

(528 F.3d at 148 (internal citation omitted).)

The Second Circuit reversed. The court of appeals started its analysis with a review of the history of the way loss has been determined under the guidelines. The court noted that prior to the amendment of Application Note 7 to the former 2F1.1, it had held

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that intended loss in loan procurement frauds "was the total value of the loan obtained or sought, without regard to whether the defendant had intended to repay the lender." (528 F.3d 150.) That rigid interpretation of loss began to change with the Third Circuit's groundbreaking decision in *United States v. Kopp*, 951 F.2d 521 (3d Cir. 1991) (Becker, J.):

> Judge Becker's opinion disagreed with *Brach* and sided with a Seventh Circuit opinion authored by Judge Posner, *see id.* at 529, 532-33, which had observed that it was "simple" but "irrational" to treat all frauds as equivalent to thefts, preferring an approach that took account of whether the defendant actually intended to pocket the face value of the amount he had fraudulently procured, *see United States v. Schneider*, 930 F.2d 555, 558-59 (7th Cir.1991). In addition, based on a careful analysis of the then-applicable version of section 2F1.1, Judge Becker rejected an approach that equated the Guidelines-approved measures of "probable" or "intended" loss with "the worst case scenario [of] *potential* loss (here, the face value of the loan)." *Kopp,* 951 F.2d at 529; *see also id.* at 533. Finally, Judge Becker observed that the approach taken by *Brach* was inconsistent with the 1991 amendments to Note 7. *See id.* at 534-35.

(528 F.3d at 151-52.)

Following *Kopp* and the 1991 amendment to Note 7, the Second Circuit "left open the possibility that a defendant is free at sentencing to present evidence of his intent regarding the issue of loss." (*Id.* at 152.) In *Confredo*, the court made explicit what in the Second Circuit had only been implied before—in fraud cases, "intended loss" refers to a defendant's "subjective intent." (*Id.*)

The principle established in *Confredo* will have the greatest impact in cases in which a defendant *intends* little or no loss, but where the *potential* for loss is greater than the loss that actually resulted. For example, in fraud cases involving mass mailing or spam e-mail, the prosecution is likely to argue that the *intended* loss is the amount of money that *could* have been lost if every recipient of the letter or e-mail sent the money requested. Although "intended loss" includes intended losses that are "unlikely" to result, section 2B1.1 Appl. Note 3(A)(ii), unlikely losses that were not actually intended are not relevant conduct. In other words, after *Confredo*, a mass mail/spam e-mail defendant should be able to argue that intended loss is no greater than actual loss where the defendant can also show that at the time the offense was committed, the defendant was aware that no more than a particular percentage of mail/e-mail recipients could be expected to respond to the solicitation. Since a defendant is presumed to intend the natural and probable consequences of his or her actions, such a defendant should be able to argue that intended loss is no greater than the loss that would result if that particular percentage of mail/e-mail recipients fell for the scheme and sent money.

Although most losses from the current financial crisis do not involve criminal activity, there will no doubt be criminal indictments involving frauds related to investment schemes involving securitized subprime mortgages and other risky loans. If the prosecution urges courts in such cases to consider the full amount of money invested as intended loss, *Confredo* offers the defense a guide on how to argue for a loss limited to those actually suffered by the investors. ■

APPRENDI ERROR

The court also recognized an unusual *Apprendi* error, albeit one "harmless" in that case. The court found that the application of a three-level upward adjustment pursuant to U.S.S.G. § 2J1.7 (offense committed while on release) violated *Apprendi,* since the defendant was not subject to the additional 10-years' consecutive imprisonment provided by 18 U.S.C. § 3147, because the facts supporting that additional punishment were never alleged in the indictment. The Second Circuit's ruling is significant, since other courts of appeals have consistently rejected *Apprendi* challenges to section 2J1.7 so long as the sentence actually imposed was within the statutory maximum provided by the statutes under which the defendant was actually convicted. (*See* United States v. Samuel, 296 F.3d 1169, 1172-76 (D.C. Cir. 2002); United States v. Randall, 287 F.3d 27, 30-31 (1st Cir. 2002); United States v. Ellis, 241 F.3d 1096, 1103-04 (9th Cir. 2001); United States v. Parolin, 239 F.3d 922, 930 (7th Cir. 2001).) Although the court's ruling on this issue is significant, it is not the subject of this column, because it involves a rarely applied guideline adjustment.

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