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The Role of Expectations in Assessing Intended Loss in Mortgage-Fraud Schemes

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INTRODUCTION

Mortgage-fraud schemes are aimed at inducing mortgage lenders to make loans they would not otherwise make based on fraudulent loan applications and the falsification of other information relating to the borrower and the value of the home, which is pledged as collateral. These schemes often result in sizeable losses to lenders, initially because a perpetrator fails to repay a fraudulently obtained loan. Then, the lender learns that the actual value of the collateral on the loan—the mortgaged property—is feeble in comparison to what it was purported to be worth in order to secure the loan, such that the entire loan is not recoverable through a foreclosure sale.

The persisting depressed economy is accommodating to the execution of mortgage-fraud schemes, providing industry insiders with expanded opportunities to exploit the vulnerable: the mortgage industry and unwitting homebuyers. For instance, the current economy affords ample opportunities for cheap purchases of low-value homes, the prices of which might then be inflated
through mortgage fraud. In addition, the recession has produced many potential homebuyers who, because of their poor credit and low income, are willing to enter sketchier-than-usual transactions with mortgage brokers or sellers of property. The losses to lenders, combined with the ill-fated outcomes for homebuyers who default on their loans and the massive and unexpected changes in property values, are the sharp results of mortgage fraud’s presence in the current economy.\footnote{In response to the problem, the Department of Justice began “Operation Malicious Mortgage,” a multiagency undertaking to combat mortgage fraud through investigative and prosecutorial efforts. Federal Bureau of Investigation, ‘Malicious’ Mortgage Fraud: More Than 400 Charged Nationwide (FBI June 2008), online at http://www.fbi.gov/page2/june08/malicious_mortgage061908.html (visited Oct 3, 2010).}

One reason these losses are significant is because defendants convicted of mortgage fraud are sentenced in accordance with § 2B1.1 of the US Sentencing Guidelines Manual, under which the amount of loss is the most weighty factor in the determination of a defendant’s sentence. The amount of loss is either the actual loss resulting from a scheme or the “intended loss.” In sentencing a defendant under § 2B1.1, there is a circuit split as to whether intended loss refers to the loss a defendant subjectively intended to inflict or the loss to be reasonably expected from the outset of the fraud.

This Comment examines the various methods of evaluating intended loss in efforts to provide a comprehensible framework for understanding the current disagreement among circuit courts, with the fundamental objective of arriving at a coherent scheme for the assessment of intended loss. I argue that although the circuit courts—when they do recognize a conflict over intended loss at all—often frame the disagreement in terms of the distinction between an objective analysis and a subjective analysis, the distinction between actual intent and constructive intent is a more accurate way of characterizing the disagreement. Ultimately, I suggest that the optimal measure of intended loss is reached by an inquiry that uses constructive intent to examine probable consequences. This approach measures intended loss by determining the amount placed at risk in a scheme.

In Section I of this Comment, I explain the nature of mortgage fraud, describing typical schemes and the losses they produce. Section II lays out the disagreement among circuit courts over the calculation of intended loss, explaining the dispute as it is framed by the courts and offering an alternative framework based on the distinction between actual and
constructive intent. In Section III, I then discuss the extent to which the various approaches are consonant with the Sentencing Guidelines and with the conventional meaning of intent in criminal law, in addition to the advantages and limitations of each inquiry. Section III concludes by suggesting that an inquiry into the amount at risk is the optimal one in terms of both sentencing goals and judicial administrability.

I. MORTGAGE-FRAUD SCHEMES AND THE ENSUING LOSSES

A. Fraud-for-Profit Schemes: Industry Insider Fraud

Mortgage fraud is defined as "a material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan." The principal category of mortgage fraud is known as "industry insider fraud." These schemes commonly utilize identity theft, straw borrowers, and shell companies, while exploiting the expertise and authority of industry insiders, including mortgage brokers, appraisers, borrowers, real estate agents, and attorneys.

Mortgage-fraud schemes involve loan applications that are falsified in order to make unqualified borrowers appear creditworthy, often through the use of fraudulent tax forms and bank records in order to overstate a borrower's income. Fraudulent appraisals are utilized in these schemes in order to obtain loans based on inflated property values, such that the lender does not realize that the borrower is receiving cash back from the transaction.

Property flipping is an example of a mortgage-fraud scheme, characterized by the purchase and quick resale—or "flip"—of properties at artificially inflated prices. In a typical property-flipping transaction, a flipper purchases a rundown house in a marginal neighborhood at a low price. The flipper then purports to make improvements to the house, but in reality makes only temporary or cosmetic improvements, adding negligible value to the property. A real estate agent markets the house, targeting an unsophisticated, low-income, first-time homebuyer. In order to obtain financing for the buyer, a mortgage broker falsifies

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documents for a lending institution so the buyer qualifies for a mortgage loan. The “improvements” are reflected in an inflated appraisal in order to falsely represent to the lender that the property is worth as much as the sale price, even though the actual value of the property has not increased. At the final stage of the scam, the flipper may enlist an attorney to represent the buyer at closing and to prepare a fraudulent title, giving the impression that the flipper has had title to the property for longer than he truly has.4

The entire transaction, from the flipper's purchase of the property through closing, takes place very quickly, sometimes in less than a week. Ultimately, the buyer is trapped with a dilapidated house and a mortgage loan in great excess of the value of the property, and when unable to continue making payments, the buyer defaults. At foreclosure, the lender rarely recoups the full value of the loan, since the value of the property is considerably less than the artificially inflated appraisal value, and the lender sustains a loss. Co-conspirators often flip many properties within a scheme, thus destroying the property market in a neighborhood and inflicting enormous losses on lending institutions.5

Alternatively, some property-flipping schemes involve transactions solely among co-conspirators. In such a case, the flipper contracts to purchase a property at a low price. Before closing the transaction, he creates a second contract to sell the property to a co-conspirator at a much higher price, inflated substantially above market value. The flipper then seeks a loan based on the second contract through a mortgage lender or broker, and a real estate appraiser inflates the value of the property in order to justify the loan. A mortgage lender approves the fraudulent loan application, issues the amount of the inflated loan, and the co-conspirators close both transactions on the property shortly thereafter. The flipper pays off the original purchase price, which only requires a small portion of the loan proceeds, and shares the remaining cash with his co-conspirators. The flipper also defaults on the loan almost immediately, and the property goes into foreclosure, at which point the lender finally learns the true value of the property and endures a significant financial loss.6

4 See United States v Cassiere, 4 F3d 1006, 1010–11 (1st Cir 1993).
5 For a description of this effect and examples, see Property “Flipping”: HUD's Failure to Curb Mortgage Fraud, S Prt 107-44, 107th Cong, 1st Sess (2001).
6 Id at 5–6.
B. Fraud-for-Housing Schemes

Offenders carry out the above mortgage-fraud schemes in order to make a profit; industry insider fraud is distinct from "fraud for housing," which consists of fraudulent loan applications that are not motivated by profit. This type of fraud involves illegal conduct on the part of the borrower only. Defendants commit fraud for housing in order to acquire property that they intend to maintain as a homeowner, and often carry out the fraud by making misrepresentations about their income and other information relevant to their credit rating, in order to obtain a loan that they intend to—and often do—fully repay.\(^7\)

II. DISAGREEMENT OVER THE ASSESSMENT OF INTENDED LOSS AT SENTENCING

In calculating the amount of loss, the circuit courts disagree on the meaning of "intended loss" as used in § 2B1.1. Since intended loss is defined as "the pecuniary harm that was intended to result from the offense,"\(^8\) it is necessary to understand what it means to intend a result; the disagreement among courts largely hinges on two facets of the definition of intent in criminal law. First, the element of intent may generally be satisfied by a showing that the defendant acted with the purpose or desire to cause a particular result, or alternatively, that the defendant had the requisite knowledge or awareness that his conduct would cause that result; this is closely aligned with the distinction between actual intent and constructive intent.\(^9\) Second, in the absence of purpose or desire, there is some ambiguity with respect to the quality of the knowledge required to satisfy the element of intent. While some authority suggests that intent is satisfied merely with knowledge that a consequence is probable, other authority urges that intent requires knowledge that a consequence is practically certain.\(^10\)

The circuit courts usually give meaning to intended loss with either an objective or subjective analysis, but the conflict may be more accurately characterized with reference to the distinction between constructive intent and actual intent. A defendant

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\(^7\) FBI, \textit{Financial Crimes Report to the Public} (cited in note 3).

\(^8\) USSG § 2B1.1 cmt n 3(A)(ii) (2009).


\(^10\) See \textit{United States v Baum}, 555 F3d 1129, 1135 (10th Cir 2009) ("[I]t is an unsettled question whether intended loss requires knowledge that the loss is a virtual certainty or only knowledge that the loss is probable."); \textit{Gypsum}, 438 US at 444.
constructively intends to cause a result when his conduct can be reasonably expected to cause that result, and in turn, actual intent is presumed.\footnote{Black’s Law Dictionary 825 (West 8th ed 2004).}

The First, Seventh, and Eighth Circuits sanction the use of a defendant’s constructive intent in order to establish intended loss. Under this approach, intended loss refers to “the loss the defendant reasonably expected to occur at the time he perpetrated the fraud.”\footnote{United States v Innarelli, 524 F3d 286, 290 (1st Cir 2008). See also United States v Staples, 410 F3d 484, 490 (8th Cir 2005).} The consideration of a defendant’s constructive intent permits courts to determine intended loss by computing expected loss; “intended loss is the amount of money that the defendant places at risk as a result of the fraudulent loan application.”\footnote{United States v Lane, 323 F3d 568, 585 (7th Cir 2003). See also United States v McCoy, 508 F3d 74, 79 (1st Cir 2007) (noting that “expected loss” would be a better term for intended loss).} The First Circuit is the only court to explicitly reject a subjective inquiry in favor of an objective one, focusing on the “objectively reasonable expectation of a person in [the defendant’s] position at the time he perpetrated the fraud, not on his subjective intentions or hopes.”\footnote{Innarelli, 524 F3d at 291.} The Seventh and Eighth Circuits define intended loss in terms of subjective intent,\footnote{See United States v Middlebrook, 553 F3d 572, 578 (7th Cir 2009) (requiring the court to “consider the defendant’s subjective intent”); Staples, 410 F3d at 490 (stating that intended loss is “the loss the defendant intended to cause to the victim”); United States v Wells, 127 F3d 739, 746 (8th Cir 1997) (“Where there is evidence of the extent of the loss the defendant intended to cause . . . the crucial question for determining intended loss for sentencing purposes is the loss that the defendant actually intended to cause.”); United States v Schneider, 930 F2d 555, 559 (7th Cir 1991) (emphasizing whether a defendant has any “intention of repaying [the] loans”).} but allow this intent to be satisfied by objective evidence: “The determination of intended loss under the Sentencing Guidelines [] focuses on the conduct of the defendant and the objective financial risk to victims caused by that conduct.”\footnote{Lane, 323 F3d at 590.}

In contrast, the Second, Third, and Fifth Circuits do not approve of using constructive intent to substantiate an intended loss. The Second and Third Circuits hold that “[i]ntended loss

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12 United States v Innarelli, 524 F3d 286, 290 (1st Cir 2008). See also United States v Staples, 410 F3d 484, 490 (8th Cir 2005).
13 United States v Lane, 323 F3d 568, 585 (7th Cir 2003). See also United States v McCoy, 508 F3d 74, 79 (1st Cir 2007) (noting that “expected loss” would be a better term for intended loss).
14 Innarelli, 524 F3d at 291.
15 See United States v Middlebrook, 553 F3d 572, 578 (7th Cir 2009) (requiring the court to “consider the defendant’s subjective intent”); Staples, 410 F3d at 490 (stating that intended loss is “the loss the defendant intended to cause to the victim”); United States v Wells, 127 F3d 739, 746 (8th Cir 1997) (“Where there is evidence of the extent of the loss the defendant intended to cause . . . the crucial question for determining intended loss for sentencing purposes is the loss that the defendant actually intended to cause.”); United States v Schneider, 930 F2d 555, 559 (7th Cir 1991) (emphasizing whether a defendant has any “intention of repaying [the] loans”).
16 Lane, 323 F3d at 590.
refers to the defendant’s subjective expectation, not to the risk of loss to which he may have exposed his victims.”¹⁷ This approach refuses to equate potential loss or expected loss with intended loss, requiring something more than knowledge of probable consequences.¹⁸ The Fifth Circuit similarly requires proof of a defendant’s “actual, not constructive, intent.”¹⁹

A. Amount of Loss under § 2B1.1 of the Sentencing Guidelines

The Guidelines Sentencing Range ("GSR") for a defendant convicted of a financial or property offense covered by § 2B1.1 is determined by several factors, the most important of which is an increase in offense level for the amount of loss resulting from the offense.²⁰ Under the Guidelines, loss is the greater of “actual loss” or “intended loss.”²¹

The Guidelines instruct that actual loss is “the reasonably foreseeable pecuniary harm that resulted from the offense,” which means “the pecuniary harm that the defendant knew or, under the circumstances, reasonably should have known, was a potential result of the offense.”²² Where a defendant has pledged collateral, the court is to credit the value of the collateral—either the amount recovered through the sale of collateral, or the fair market value of the collateral at the time of sentencing—against the loss.²³ In a mortgage-fraud scheme, the actual loss is generally the gross amount of fraudulently obtained mortgage loans, minus the sum of any payments on the loans before the defendant’s arrest and the sales prices of properties sold at fore-

¹⁷ United States v Yeaman, 194 F3d 442, 460 (3d Cir 1999). See also United States v Confredo, 528 F3d 143, 152 (2d Cir 2008) (requiring proof of "subjective intent").

¹⁸ See Baum, 555 F3d at 1133; Confredo, 528 F3d at 152 ("[T]he defendant should have an opportunity to persuade the sentencing judge that the loss he intended was less than the face amount of the loans."); United States v Kopp, 951 F2d 521, 536 (3d Cir 1991) (holding that "loss" should not be equated with the full amount of loans or "potential loss as measured at the time of the crime").

¹⁹ United States v Goss, 549 F3d 1013, 1017 (5th Cir 2008). See also United States v Sanders, 343 F3d 511, 527 (5th Cir 2003) (requiring proof of a defendant's "subjective intent to cause the loss that is used to calculate his offense level").


²¹ USSG § 2B1.1 cmt n 3(A) (2009). Alternatively, the Guidelines permit a court to use the gain that resulted from the fraud as a measure of loss "only if there is a loss but it reasonably cannot be determined." USSG § 2B1.1 cmt n 3(B) (2009). A sentencing court "need only make a reasonable estimate of the loss" based on available information. USSG § 2B1.1 cmt n 3(C) (2009).

²² USSG § 2B1.1 cmt n 3(A)(i), (iv) (2009).

closure.\textsuperscript{24} When foreclosure sales have not taken place, actual loss is the amount of loans minus the fair market value of the collateral at the time of sentencing, usually estimated by an appraisal of the property.\textsuperscript{25}

Intended loss, on the other hand, is defined as "the pecuniary harm that was intended to result from the offense," including such harm "that would have been impossible or unlikely to occur (e.g., as in a government sting operation, or an insurance fraud in which the claim exceeded the insurer's value)."\textsuperscript{26} This language does not provide a formula to be used in calculating intended loss, and courts have not been altogether consistent in interpreting this instruction, with respect to the meaning of "intended" and the inclusion of impossible losses.

The Guidelines are premised upon the notion that when a defendant is convicted of a federal offense, his sentence should correlate with the "nature and magnitude of the loss caused or intended" by the crime; "loss serves as a measure of the seriousness of the offense and the defendant's relative culpability and is a principal factor in determining the offense level under [§ 2B1.1]."\textsuperscript{27} Loss controls the analysis; the fact that a defendant does not profit from his fraud does not preclude a victim from suffering a loss, nor does it preclude a sentencing enhancement.\textsuperscript{28}

Further, the Guidelines instruct that in the case of criminal activity jointly undertaken by the defendant and others, the relevant conduct of all participants in the scheme should be included in the amount of loss.\textsuperscript{29} Consequently, the amount of loss for which a defendant is responsible is not limited to the proceeds pocketed by the defendant himself, but includes the loss produced by the entire scheme, so long as the result was reasonably foreseeable.\textsuperscript{30} Because of the nature of the crime of mortgage fraud, offenders often operate within a scheme, so it is crucial to recognize relevant conduct for which a defendant may be held responsible.

\textsuperscript{24} See, for example, \textit{United States v Wilkins}, 2009 WL 211812, *7 (6th Cir).
\textsuperscript{25} See, for example, \textit{United States v Parish}, 565 F3d 528, 535 (8th Cir 2009); \textit{United States v Crandall}, 525 F3d 907, 914–15 (9th Cir 2008) (describing various ways to measure the fair market value of collateral in fraud involving real property).
\textsuperscript{26} USSG § 2B1.1 cmt n 3(A)(ii) (2009).
\textsuperscript{27} USSG § 2B1.1 background (2009).
\textsuperscript{28} \textit{United States v Fazio}, 487 F3d 646, 658 (8th Cir 2007).
\textsuperscript{29} USSG § 1B1.3(a)(1)(B) (2004).
\textsuperscript{30} Wilkins, 2009 WL 211812, at *7.
The Sentencing Guidelines are advisory; a sentence is reviewed on appeal for reasonableness under an abuse-of-discretion standard.\textsuperscript{31} Even though they are no longer mandatory, the Guidelines remain an important part of sentencing. An appeals court may, but is not required to, apply a presumption of reasonableness to sentences imposed within the correctly calculated GSR.\textsuperscript{32} The standard of review requires an appellate court to ensure that the district court committed no significant procedural error, such as failing to calculate (or improperly calculating) the Guidelines range . . . . Assuming that the district court’s sentencing decision is procedurally sound, the appellate court should then consider the substantive reasonableness of the sentence imposed under an abuse-of-discretion standard.\textsuperscript{33}

This means that despite the advisory nature of the Guidelines, a district court is still required to properly calculate the GSR for its determination of the sentence to impose; “the Guidelines should be the starting point and initial benchmark.”\textsuperscript{34} Additionally, the commentary accompanying a guideline has the same authority as the guideline itself.\textsuperscript{35}

B. Constructive Intent: Reasonable Expectations of Loss

The distinction between fraud for profit and fraud for housing, particularly with respect to a defendant’s purpose in committing each offense, is helpful in understanding intended loss. In fraud for profit, a defendant makes misrepresentations in order to acquire a loan from which he intends to make a profit by failing to repay at least a portion of the loan, or abandoning the loan secured by collateral of insufficient value; his failure to repay inflicts a loss, usually on the lender. In fraud for housing, a defendant makes misrepresentations in order to acquire a loan that he sincerely intends and—in some cases, reasonably—

\textsuperscript{31} United States v Booker, 543 US 220, 261 (2005).
\textsuperscript{33} Gall v United States, 552 US 38, 51 (2007).
\textsuperscript{34} Id at 49.
\textsuperscript{35} Stinson v United States, 508 US 36, 38 (1993) ("[C]ommentary in the Guidelines Manual that interprets or explains a guideline is authoritative unless it violates the Constitution or a federal statute, or is inconsistent with, or a plainly erroneous reading of, that guideline.").
expects to repay, but for some reason, he would not have been eligible for the loan without the misrepresentations.

This distinction has often been described on a more general level by the circuit courts:

[I]t is necessary to distinguish between two types of fraud. One is where the offender—a true con artist—does not intend to perform his undertaking, the contract or whatever; he means to pocket the entire contract price without rendering any service in return. In such a case the contract price is a reasonable estimate of what we are calling the expected loss . . . . The other type of fraud is committed in order to obtain a contract that the defendant might otherwise not obtain, but he means to perform the contract (and is able to do so).36

While the broader distinction is not a perfect comparison, it is a useful one because it sheds light on intended loss. In fraud for profit, the defendant is a con artist, but because in most cases there is collateral pledged to secure the loan, he does not ordinarily intend to pocket the entire contract price. Instead, he intends to pocket the difference between the amount of the loan and the collateral on the loan; this value is the expected loss.37 Conversely, other defendants fraudulently applying for loans, such as in fraud for housing, often make misrepresentations in order to obtain a loan for which they have a legitimate use, and which they truly intend to repay.38

The difference between perpetrators of fraud for profit and fraud for housing elucidates the relationship between subjective intent and objective expectations. It is fundamental that the con artist has a very different subjective intent from the perpetrator who intends to perform the contract by repaying the loan. Likewise, the objective financial risk and reasonable expectations of losses are greater in the case of the con artist, who has no reason

36 Schneider, 930 F2d at 558. See also United States v Triana, 468 F3d 308, 322 (6th Cir 2006); United States v Blastos, 258 F3d 25, 30 (1st Cir 2001); United States v Edgar, 971 F2d 89, 95 (8th Cir 1992); United States v Smith, 951 F2d 1164, 1169 (10th Cir 1991).
37 See United States v Lauer, 148 F3d 766, 768 (7th Cir 1998) ("In fraudulent loan application cases the loss is the part of the loan that the defendant does not intend to repay, or the value of the part of the contractual performance that he intends to omit, rather than the entire loan or entire contract price.").
38 See, for example, United States v Erpenbeck, 532 F3d 423, 432 (6th Cir 2008) (observing that the defendant "was attempting to temporarily resolve his cash-flow problem"); United States v Oligmueller, 198 F3d 669, 670 (8th Cir 1999) (noting the defendant's "extraordinary efforts to insure that his debt was repaid to the bank").
to expect anything but the maximum potential loss. The efforts of
the defrauder who retains control over the collateral and does
not abandon repayment suggest that it is reasonable to expect a
loss of less than the potential loss; since he is not a con artist, his
control over the situation and expectations of repayment also
serve to mitigate the amount at risk in his fraud.

As such, the subjective standard announced by the Seventh
and Eighth Circuits aligns with the First Circuit's objective
approach; these courts focus on a defendant's subjective intent
only when the defendant's subjective intent to repay a fraudulent
loan is consistent with reasonable expectations of repayment.39
The assessment must take into account the defendant's conduct
alongside the objective risk caused by the conduct.40

In calculating intended loss through an evaluation of ex-
pected loss, the unsecured portion of the loan—the gross amount
of the fraudulent loan, offset by the value of the collateral—is a
"common-sense estimate of the interim risk faced by the lending
institution."41 When there is no evidence that a defendant in-
tended to cause any less than the greatest possible loss—the
amount at risk—"the amount of loss for sentencing purposes . . .
is found by determining the intended loss as measured by the
possible loss."42 This approach computes intended loss "from the
perspective of a reasonable person in the defendant's position at
the time of the fraud," looking at what a reasonable person would
have expected.43

The measure of the loss that the defendant intended to in-
flict—"the increased risk from lending excessive amounts of

39 See McCoy, 508 F3d at 79 (explaining that intended loss could be zero where "the
defendant sincerely intended and reasonably expected fully to repay the loan"), citing
Schneider, 930 F2d at 559.
40 Lane, 323 F3d at 590.
41 Id at 586. See also United States v Miller, 588 F3d 560, 566-67 (8th Cir 2009).
42 Wells, 127 F3d at 746. See also Staples, 410 F3d at 490 (noting that the maximum
amount of loss may be "circumstantial evidence of the intended loss which satisfies the
preponderance of the evidence standard").
43 Innarelli, 524 F3d at 291; Staples, 410 F3d at 490–91. The Fourth and Sixth Cir-
cuits have in some instances engaged in this type of inquiry. See United States v
Pendergraph, 388 F3d 109, 114 (4th Cir 2004) (noting that "expected loss might provide
evidence of whether the defendant intended any loss," but also that "the absence of in-
tended loss renders expectations irrelevant under the guideline"); United States v Baum,
974 F2d 496, 499 (4th Cir 1992) (holding that when the defendant induces a lender to
subject itself to a greater risk of default, even if the defendant intends to fully repay the
loan, loss is measured by the potential consequences of default); United States v Smith,
2006 WL 2385338, *4 (ND Ohio) (holding that intended loss is the maximum loss that a
reasonable person in the defendant's position could have intended), affd, 2007 WL
2088686 (6th Cir).
money on the collateral”—is the amount by which the fraudulent loan exceeds the amount that the lender would have lent in the absence of the fraud, having known the true facts. Generally, courts compute this amount on the assumption that had there been no misrepresentations, the amount of the loan would be equal to the value of the collateral. Accordingly, the expected loss equals the difference between the amount of the fraudulent loan and the expected value of the property, a proxy for the value of the collateral. The rationale for using the expected value of each property is that a defendant causes loans in amounts greater than the value of the underlying collateral to end up in the hands of individuals who are often neither qualified for the loans nor concerned with repayment. Therefore, in property flipping or other fraud for profit, the defendant has no reasonable basis to expect that the mortgage payments will be made; he can only expect lenders to recover the value of the mortgaged properties.

A proxy for the value of the collateral should be determined from the outset of the fraud. Depending on the circumstances of the offense, courts measuring expected loss tend to choose the most appropriate of the original purchase price, an accurate appraisal value, and the sale price.

The flipper's original purchase price is often used as the expected value of each property in a property-flipping scheme. As these schemes take place very quickly, a defendant’s reasonable expectation at the time of the fraud is unaffected by changes in the property’s value during the course of the scheme before the actual loss is realized. The First Circuit calculated intended

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44 United States v Carter, 412 F3d 864, 869 (8th Cir 2005). See also Kok v United States, 17 F3d 247, 250 (8th Cir 1994) (measuring intended loss as “the difference between the amount of credit the bank extended based on the false representations and the amount of credit the bank would have extended had it known the [borrower’s] true financial condition”); United States v Chorney, 63 F3d 78, 83 (1st Cir 1995) (“Where a bank loan is fraudulently procured, the original loan or the outstanding balance is a presumptive proxy for the actual or threatened loss. Reducing that amount by the value of assets pledged to the lender reflects the fact that the real sum at risk for the lender is the difference between the amount loaned and the collateral.”).

45 Lane, 323 F3d at 590 (“This estimate of loss similarly has the advantage of not making the term of a criminal sentence turn on conjecture.... This determination also applies even when the amount at risk was not lost.”) (quotation marks omitted).

46 Id at 590 n 8 (“[F]or intended loss purposes courts should examine the status quo at the time the fraudulent loan application is made.”). See also Miller, 586 F3d at 566 (focusing on the amounts that lenders would have issued had they known the borrowers’ true financial conditions, examining the outset of the fraud).

47 See McCoy, 508 F3d at 79 (“[The flippers] had no knowledge of how long it would take before the innocent buyers defaulted and their properties were foreclosed on by lenders and resold. That this took long enough that some properties went up in market price (and others down) has nothing to do with culpability.”); United States v Barren,
loss this way in United States v Innarelli, where the property-flipping scheme involved collusion among buyers, mortgage brokers, appraisers, and a lawyer. Some of the properties appreciated in value during the scheme, such that the lender recovered the full amount of the mortgage loan through sale at foreclosure, and some of the buyers of flipped properties continued making payments on the inflated mortgage loans and did not default; in consequence, there was no actual loss with respect to these properties. The First Circuit calculated the intended loss for each property by subtracting the property flippers' purchase price from the amount of the mortgage loan on the property. The court held that it was immaterial that the defendant never subjectively intended to cause such a loss, or that many of the lenders suffered no actual losses: "Where, as here, the defendant reasonably should have expected that loss would result, he can and generally should be punished more severely to account for his greater level of moral culpability, even where the victim has managed to make money in spite of the fraud."

The Seventh Circuit examined intended loss in a similar property-flipping scheme, explaining that in that case, the foreclosure price was the appropriate substitute for the value of the collateral. In United States v Radziszewski, the defendant and other plotters flipped the same property several times, hiring individuals with good credit to provide false documentation for loan applications. The Seventh Circuit affirmed the computation of intended loss as the difference between the amount of the loan that the victim bank intended to issue for the resale of the property, which had already been flipped, and the amount recovered by the lender through foreclosure. The court rejected

2008 WL 5070310, *4 (ND Ill) ("It was reasonable for the court, in order to determine [the defendant's] culpability at the time of the fraud, to conclude that the amount [the defendant] paid for the property was an accurate approximation of the fair market value of the properties only a short time later.").

48 524 F3d 286 (1st Cir 2008).

49 Id at 291. See also McCoy, 508 F3d at 79 (measuring intended loss in a property-flipping scheme by subtracting the price at which the property was purchased from the amount of the fraudulently inflated mortgage loan); Barren, 2008 WL 5070310, at *4 (same); United States v Aihe, 2004 WL 2434713, *3 (D Minn) (same).

50 Innarelli, 524 F3d at 291. See also United States v Helfand, 2008 WL 2368963, *10 (7th Cir) ("[A] fraud victim's effort to mitigate its losses does not lessen the wrongdoer's liability.").

51 474 F3d 480 (7th Cir 2007).

52 Id at 482.

53 Id at 487. See also Helfand, 2008 WL 2368963, at *6 (using the difference between the mortgage loan and the amount recovered at resale for intended loss when there was no actual loss).
the defendant’s proposal to use an appraisal of the house as a proxy for collateral, since the appraisal value was greater than the foreclosure price and more speculative. Since there were several transactions on the same property, the foreclosure price served as the best estimate of the property’s value at the time of the fraudulent sale.\(^{54}\)

Using the same methodology, the Eighth Circuit calculated intended loss in a different type of fraud-for-profit scheme in *United States v Carter*.\(^{55}\) The perpetrators of the mortgage-fraud scheme worked in the loan brokerage business, and they falsified documentation of sales prices and of borrowers’ financial means in order to obtain fraudulently inflated loans in greater amounts than the lenders would have otherwise lent to the particular borrowers, who had poor credit, or on the particular houses, which were not as valuable as they were represented to be.\(^{56}\) The defendant diverted the excess funds on each fraudulent mortgage loan from the closing and title company to another company controlled by him. The Eighth Circuit observed that the intended loss could be estimated as the amount by which the defendant caused the loans to be overfunded; “the amount disbursed to [the defendant’s company] on each loan was the same amount as that by which the fraudulently-obtained loan exceeded the amount that the lenders would have lent on the property had they known its true value.”\(^{57}\) There was neither evidence that any mortgages had been foreclosed upon, nor evidence providing a basis for actual loss calculations, so the court explained that the amount diverted by the defendant—the sum of the excess amounts on all of the loans—was “a good proxy for the lenders’ likely losses on the loans.”\(^{58}\)

The Eleventh Circuit, too, finds the fact that a defendant “intentionally induced a bank to unknowingly subject itself to the risk of default […] sufficient to establish that the defendant intended to cause a loss.”\(^{59}\) In *United States v Greene*,\(^{60}\) the defendant participated in a mortgage-fraud scheme in which he secured

\(^{54}\) Radziszewski, 474 F3d at 487.
\(^{55}\) 412 F3d 864 (8th Cir 2005).
\(^{56}\) Id at 866.
\(^{57}\) Id at 869.
\(^{58}\) Id at 870.
\(^{59}\) United States v Menichino, 989 F2d 438, 442 (11th Cir 1993) (rejecting the contention that the government had to show that the defendant believed the loan would not be repaid), citing Baum, 974 F2d at 496.
\(^{60}\) 2008 WL 2222044 (11th Cir).
loans for unqualified buyers through the establishment of shell companies, inflated appraisals of properties, and credit information of straw buyers.\textsuperscript{61} On appeal, the court addressed the intended loss calculations concerning two properties. On the first, the mortgage lender made a profit because the property was sold at foreclosure for a price higher than the amount of the original loan. The Eleventh Circuit affirmed the district court’s calculation, which measured intended loss by using the purchase price “as a proxy for fair market value.”\textsuperscript{62} On the second property, the court affirmed the district court’s use of the appraisal value, holding that under the Guidelines, loss should be determined based on “available information.” Since the property had not been foreclosed upon, the appraisal value was the only information; actual loss could not be determined, so it was proper to use intended loss instead.\textsuperscript{63}

C. Actual Intent: Subjective Intent to Inflict a Particular Loss

In contrast, several circuit courts hold that the amount put at risk by the defendant’s scheme is not an appropriate measure of intended loss.\textsuperscript{64} The Second, Third, and Fifth Circuits require evidence that a defendant subjectively intended to inflict a loss, refusing to equate intended loss with an objective measure of expected loss, potential loss, or the amount at risk: “Intended loss refers to the defendant’s subjective expectation, not to the risk of loss to which he may have exposed his victims.”\textsuperscript{65} The Third Circuit has emphasized that there is a distinction between intending a loss and expecting a loss.\textsuperscript{66} Likewise, the Fifth Circuit requires that the government show that a defendant intended to not repay an amount for that amount to constitute intended loss, holding that actual loss must be used as the amount of loss.

\textsuperscript{61} Id at *2.
\textsuperscript{62} Id at *6.
\textsuperscript{63} Id at *20–21. See also United States v Fraza, 106 F3d 1050, 1055 (1st Cir 1997) (measuring loss by deducting a property’s appraisal value from the amount of mortgage loans); USSG § 2B1.1 cmt n 3(C) (2009) (“The estimate of the loss shall be based on available information.”).
\textsuperscript{64} See, for example, United States v Ravelo, 370 F3d 266, 270–71 (2d Cir 2004); Yeaman, 194 F3d at 460; United States v Orton, 73 F3d 331, 334–35 (11th Cir 1996).
\textsuperscript{65} Yeaman, 194 F3d at 460 (remarking that the defendants hoped their scheme would continue indefinitely). See also Confredo, 528 F3d at 151–52, citing Yeaman, 194 F3d at 460; Goss, 549 F3d at 1017 (focusing on “actual, not constructive, intent”); Kopp, 951 F2d at 529.
\textsuperscript{66} United States v Geevers, 226 F3d 186, 188 (3d Cir 2000). See also Kopp, 951 F2d at 529 (observing “a critical distinction between actual, probable, and intended loss”).
when there is no evidence of a defendant’s intent not to repay.\footnote{Sanders, 343 F3d at 527. See also Goss, 549 F3d at 1017 (noting that in the absence of evidence that a defendant intended to cause the loss of the loans or that he intended that they be repaid, the court examines whether a defendant was so “consciously indifferent or reckless about the repayment of the loans as to impute to him the intention that the lenders should not recoup their loans”) (quotation marks omitted).} Under this inquiry, it is inappropriate to consider the amount of a loan that a defendant received or intended to receive as a factor in determining intended loss.\footnote{The Fifth Circuit’s analysis tends to facilitate either a complete rejection of intended loss, or a result attributing the full amount of the loans to intended loss, on the basis that the defendant did not intend to repay any of the loans. See Sanders, 343 F3d at 526 (justifying the rarity of sentences based on intended loss in the Fifth Circuit).}

In \textit{United States v Baum},\footnote{555 F3d 1129 (10th Cir 2009).} the Tenth Circuit commented that the “question whether intended loss requires knowledge that the loss is a virtual certainty or only knowledge that the loss is probable” was unsettled. The court noted the significance of this issue, as it could have been dispositive in that case—the evidence supported a finding that the calculated amount of intended loss was a probable consequence, but not a virtual certainty.\footnote{Id at 1135 (affirming the intended loss calculation based on probable loss under a plain error standard, without providing an answer with respect to the knowledge required for intent).} The effect of the disagreement among circuit courts is illuminated by a comparison of the loss calculations carried out by the courts.

The Second Circuit considered the magnitude of intended loss resulting from a fraudulent loan application scheme in \textit{United States v Confredo}.\footnote{528 F3d 143 (2d Cir 2008).} The defendant, a former loan officer, prepared and submitted hundreds of fraudulent loan applications in order to obtain loans for borrowers with poor credit. The district court found that intended loss was the proper figure for a sentencing enhancement, which it calculated to be the combined face value of the loan applications that the defendant had submitted, since that amount was greater than the actual loss resulting from the scheme.\footnote{Id at 146.} The defendant contended that he did not intend such a large loss, on the basis that he expected some of the loan applications to be rejected and expected some of the borrowers to make payments on the fraudulent loans; he supported his claim by pointing to his experience as a loan officer in addition to what had actually happened—the resulting actual
INTENDED LOSS IN MORTGAGE-FRAUD SCHEMES

Holding that "the defendant should have an opportunity to persuade the sentencing judge that the loss he intended was less than the face amount of the loans," the Second Circuit remanded the case for reconsideration of the defendant's sentence. The court explained that the intended loss should be based only on what the defendant subjectively intended to occur as a consequence of his fraud.\(^{74}\)

The principal difference between _Confredo_ and many mortgage-fraud schemes is the absence of collateral to secure the loans in _Confredo_; this is of little weight.\(^{75}\) As the district court remarked:

[The defendant] undertook no obligation himself to pay off the loans he secured. His 'cut' was paid when the loans were secured; it did not matter whether they were paid back. [The defendant] is not a borrower who used fraud to obtain a loan which he then paid back in full.\(^{76}\)

This framework of analysis, rejected by the Second Circuit, seems to be consistent with the approach taken by other courts.\(^{77}\) In spite of this, the appellate court made no mention of the reasonableness of the defendant's expectations—only his subjective intent. Even so, the defendant's conduct indicates that his intent was aligned with that of the con artist as opposed to the defrauder who intends to fully repay his loans. Under the First, Seventh, and Eighth Circuits' approach, the fact that the defendant had no control over repayment, that he personally profited from the scheme, and that he continued to arrange fraudulent loans while on bail after his arrest, would likely convince a court that there was no basis for reasonable expectations of repayment. This objective inquiry would likely hold the defendant's subjective intent to be wholly irrelevant because it was so

\(^{73}\) Id at 149.

\(^{74}\) Id at 152, citing _Kopp_, 951 F2d at 533.

\(^{75}\) The fraudulent loans at issue in _Confredo_ were not secured by collateral. The Second Circuit's discussion of "credit for objective facts" is based on the application note accompanying § 2B1.1, which directs a sentencing court to credit the collateral against the loss. Since there was no collateral, unless the court was calculating actual loss—in which case it would offset the loss by the amount repaid by borrowers—this application note would not seem to apply to the defendant. Additionally, it was very clear that the court was discussing intended loss, not actual loss. See _Confredo_, 528 F3d at 151; USSG § 2F1.1 cmt n 7(b) (1997).

\(^{76}\) _Confredo_, 528 F3d at 148.

\(^{77}\) See _United States v McBride_, 362 F3d 360, 375 (6th Cir 2004) (explaining that the disparity between actual loss and intended loss should only be considered when deciding whether a departure is warranted).
inconsistent with the objective financial risk resulting from the scheme.\textsuperscript{78}

In \textit{United States v Goss},\textsuperscript{79} the Fifth Circuit examined the loss resulting from a mortgage-fraud scheme that was aimed at inducing lenders to make loans to borrowers who may not have qualified for them otherwise. The defendant was a mortgage lender who prepared false documents—false verifications of deposit and rent, IRS W-2 forms, and Social Security benefit letters—and provided them to lenders to obtain mortgages.\textsuperscript{80} The Fifth Circuit observed that there was no evidence that the defendant intended to cause the loss of the loans, nor that he intended that the loans be repaid, and held that even though the defendant did not have control over repayment, he was not so "consciously indifferent or reckless" about the repayment as to impute to him the intention that the loans not be repaid.\textsuperscript{81} Consequently, the court held that actual loss was the appropriate calculation, refusing to consider intended loss.\textsuperscript{82} This approach is not concerned with risk, but rather with subjective intent. However, it is difficult to ascertain the point at which the Fifth Circuit finds conscious indifference or recklessness regarding repayment; the defendant in Goss was the perpetrator of a mortgage-fraud scheme carried out for profit, he had no control over repayment, and he actually did profit from the scheme.

In \textit{United States v Breon},\textsuperscript{83} the Fifth Circuit affirmed the district court's calculation of the defendant's sentence for his participation in a property-flipping scheme, in which he flipped a property three times. One of the loans fraudulently obtained by the defendant was fully repaid by a subsequent flip of the property, so there was no actual loss on that transaction; the district

\textsuperscript{78} Compare Wells, 127 F3d at 747 ("[W]here there is no indication that the defendant intended to cause less than the greatest possible loss, the intended loss is the possible loss."). with \textit{Confredo}, 528 F3d at 146; \textit{Sanders}, 343 F3d at 525 (holding that a measure of intended loss was inappropriate because the defendant asserted that he intended to repay his loan, and because there was no "evidence indicating his intent not to repay"). But see \textit{United States v Morrow}, 177 F3d 272, 301-02 (5th Cir 1999) (inerring the defendants' conscious indifference or recklessness about the repayment of loans, which warranted the use of intended loss measured by the full amount of loans); \textit{United States v Tedder}, 81 F3d 549, 551 (5th Cir 1996) (using the full amount of loans as intended loss, finding it highly unlikely that the defendant intended to repay the loans).

\textsuperscript{79} 549 F3d 1013 (5th Cir 2008).

\textsuperscript{80} Id at 1014.

\textsuperscript{81} Id at 1018. But see \textit{Morrow}, 177 F3d at 301 (finding the defendants "consciously indifferent or reckless" about repayment where the defendants had no control over repayment, and calculating intended loss).

\textsuperscript{82} \textit{Goss}, 549 F3d at 1018.

\textsuperscript{83} 2009 WL 4885190 (5th Cir).
court found that the only actual or intended loss was to one lender relating to the third flip of the property.\textsuperscript{84} This sentence does not seem to reflect the amount at risk in the defendant's scheme, which would require an assessment from the outset of the fraud; the fact that a result actually occurred is not necessarily proof that the result could have been reasonably expected.

III. DECIPHERING THE VARIOUS CONCEPTIONS OF INTENDED LOSS

A. Conventional Understandings of Intended Loss and Intent

In order to evaluate the various interpretations of intended loss, the history of the relevant section of the Guidelines provides some assistance. The Sentencing Guidelines took effect in 1987.\textsuperscript{85} Under the original Guidelines, a defendant convicted of mortgage fraud was sentenced under § 2F1.1, while a defendant convicted of theft was sentenced under § 2B1.1.\textsuperscript{86} Until 1991, the relevant commentary provided the definition of intended loss as "probable or intended loss."\textsuperscript{87} A 1991 amendment deleted the word "probable" from this definition, leaving only "intended loss."\textsuperscript{88} In 2001, an amendment deleted an application note that provided:

In fraudulent loan application cases and contract procurement cases, the loss is the actual loss to the victim (or if the loss has not yet come about, the expected loss). . . . However, where the intended loss is greater than the actual loss, the intended loss is to be used.\textsuperscript{89}

Also in 2001, former § 2F1.1 was combined with former § 2B1.1, yielding the current § 2B1.1, which applies to both fraud and theft.\textsuperscript{90}

Although there is no longer any reference to expected loss or probable loss in the relevant section of the Guidelines, it does not necessarily follow that the current language of § 2B1.1 precludes an objective inquiry into the reasonable expectations of someone

\textsuperscript{84} Id at *2 (affirming the district court's calculation of loss, even though it did not clarify whether it had calculated actual loss, intended loss, or gain, since "its estimate reasonably could have been based on any of the three methods").
\textsuperscript{85} USSG ch 1, part A.
\textsuperscript{86} USSG § 2B1.1 (2000); USSG § 2F1.1 (2000).
\textsuperscript{87} USSG § 2F1.1 cmt n 7 (1990).
\textsuperscript{88} USSG app C, amend 393 (1991).
\textsuperscript{89} USSG § 2F1.1 cmt n 8(b) (2000); USSG app C, amend 617 (2001).
\textsuperscript{90} USSG app C, amend 617 (2001).
in the defendant's position.\textsuperscript{91} Courts have often defended a standard for intended loss that can be equated with an inquiry into expected loss by pointing to the "common-law rule that a person is presumed to have generally intended the natural and probable consequences of his or her actions."\textsuperscript{92}

The Supreme Court addressed the appropriate standard of intent in criminal law in \textit{United States v United States Gypsum Company}.\textsuperscript{93} Although the decision does not contain a solution to the current disagreement regarding intended loss, it does provide guidance. The Court examined whether proof of intent required that the "conduct was undertaken with the conscious object of producing such effects," or whether it was sufficient that the conduct was "undertaken with knowledge that the proscribed effects would most likely follow."\textsuperscript{94} In \textit{Gypsum}, the Court held that evidence of "action undertaken with knowledge of its probable consequences" was sufficient to demonstrate intent.\textsuperscript{95} The Court explained:

Generally [the] limited distinction between knowledge and purpose has not been considered important since there is good reason for imposing liability whether the defendant desired or merely knew of the practical certainty of the results.

\ldots

Where carefully planned and calculated conduct is being scrutinized in the context of a criminal prosecution, the perpetrator's knowledge of the anticipated consequences is a sufficient predicate for a finding of criminal intent.\textsuperscript{96}

\textit{Gypsum} makes clear that a finding of intent does not require evidence of purpose or desire so long as a defendant had the requisite knowledge, but the Court did not announce a standard for that level of knowledge. Instead, the Court used varied language with respect to a defendant's knowledge: knowledge of "likely" effects; knowledge of "anticipated" consequences;

\begin{itemize}
  \item \textsuperscript{91} See \textit{Baum}, 555 F3d at 1134.
  \item \textsuperscript{92} \textit{United States v Alli}, 444 F3d 34, 38 (1st Cir 2006) (holding that reasonably foreseeable loss constitutes intended loss). See also \textit{Gypsum}, 438 US at 430.
  \item \textsuperscript{93} 438 US 422 (1978).
  \item \textsuperscript{94} Id at 444.
  \item \textsuperscript{95} Id.
  \item \textsuperscript{96} Id at 445–46, quoting W. LaFave and A. Scott, \textit{Criminal Law} 197 (1972) (quotation marks omitted).
\end{itemize}
knowledge of "probable" consequences or that the results "would most likely follow"; and knowledge that the consequences were "practically certain to follow." 97

While the Tenth Circuit has remarked that there is "substantial support for a view contrary to ... that of the First Circuit, which said that a loss is intended if it is expected," 98 most circuit courts continue to examine probable loss in their discussion of intended loss, at least in some instances, using language that strongly suggests that a loss need not be practically certain to follow from the defendant's conduct in order to constitute an intended loss. 99

B. The Economic Reality Doctrine

The "economic reality doctrine" is the proposition that if the possible loss resulting from a fraud is less than the intended loss, the possible loss should govern. 100 In light of the current formulation of intended loss under § 2B1.1, clearly including intended harm "that would have been impossible or unlikely to occur (e.g., as in a government sting operation, or an insurance fraud in which the claim exceeded the insured value)," it is generally agreed that the economic reality doctrine no longer has a place in the determination of intended loss. 101

97 Gypsum, 438 US at 444-46.
98 Baum, 555 F3d at 1136, citing McCoy, 508 F3d at 79, and referring to Gypsum, 438 US at 445-46.
99 See, for example, United States v Gallant, 537 F3d 1202, 1236-37 (10th Cir 2008) ("If there is no actual loss or if a probable or intended loss is greater than the actual loss, the larger figure will be used."); Alli, 444 F3d at 38 (holding that a "reasonable expectation, if not knowledge ... is enough ... to demonstrate intended loss," following "the common-law rule that a person is presumed to have generally intended the natural and probable consequences of his or her actions"); United States v Harms, 442 F3d 367, 380 (5th Cir 2006) ("Loss for purposes of the Guidelines is the actual, intended, or probable loss to the victims."); United States v Parsons, 109 F3d 1002, 1004 (4th Cir 1997); United States v Canova, 412 F3d 331, 354 (2d Cir 2005) ("Intended loss is tantamount to the probable loss from a particular misstatement because one is presumed to intend the natural and probable consequences of one's acts."); United States v Miller, 316 F3d 495, 499 (4th Cir 2003) ("Loss calculations may include actual, probable, or intended loss to the victims.") (quotations marks omitted); Lane, 323 F3d at 589 ("It is enough if [a loss] is probable or intended."); United States v Piggie, 303 F3d 923, 927 (8th Cir 2002) (holding that the amount of loss may be based on losses "intended as the natural and probable consequences of the defendant's actions.").
100 See United States v Merritt, 2004 WL 1418432, *6 n 7 (4th Cir).
101 Id; USSG § 2B1.1 cmt n 3(A)(ii) (2009). See also Ravelo, 370 F3d at 270-71 ("The definition of 'intended loss' now makes clear, however, that a loss may be intended irrespective of whether it could actually occur."); McBride, 362 F3d at 375 (explaining that economic reality—whether a loss is possible—may warrant a downward departure but is not an appropriate consideration in the intended loss calculation). But see Smith, 2006 WL 2385338, at *4 ("[F]or an amount of loss to be considered for purposes of
Several circuit courts have gone a step further, holding that § 2B1.1 must also preclude a measure of intended loss based on the amount at risk.\textsuperscript{102} While the criticism of an approach endorsing a “policy of punishing criminals in light of economic reality or amounts put at risk,”\textsuperscript{103} is consistent with the prevailing dismissal of the economic reality doctrine, the rationale for rejecting an inquiry into the amount at risk altogether does not seem to be equally defensible. These courts reject the inquiry on the basis that considering the amount at risk necessarily limits the inquiry to losses that are “realistic or possible,” imposing an impossibility or improbability limitation on intended losses, which is contrary to the language of § 2B1.1.\textsuperscript{104}

This reliance on the demise of the economic reality doctrine in loss calculations in order to assert the irrelevance of the amount at risk seems to misunderstand the alternative approach that continues to examine the amount at risk. Specifically, when courts reject giving weight to the amount at risk, they do so because they view an inquiry that examines possible or potential consequences as a narrow one. The Second Circuit, for example, understands the amount at risk or the potential loss as restricted literally to the actual amount each victim stood to lose. On this view, the narrow inquiry into the amount at risk stands in stark contrast to the Second Circuit’s broad inquiry into all intended losses, whether likely or unlikely, possible or impossible.\textsuperscript{105} Quite the reverse, courts that use the amount at risk in order to compute intended loss view the assessment of potential consequences as a way of expanding the inquiry beyond that which is confined to subjective intent, in order to account for reasonable expectations or probable consequences that might not have been contemplated by a defendant.\textsuperscript{106}
It is clear enough that § 2B1.1 regards some impossible and unlikely losses within the ambit of intended loss. It may also be prudent to try to take more meaning from the examples provided, namely a government sting operation and an insurance claim in excess of the insured value. Both of these are situations in which an external circumstance, unknown to the defendant and over which the defendant has no control, is the sole barrier to the defendant's successful completion of the offense. It seems unlikely that a court giving weight to constructive intent would conclude that there was no intended loss in either example; neither situation affects the reasonable expectations of someone in the defendant's position. Even though the loans would not technically be at risk and the intended loss would be impossible, the use of reasonable expectations ensures that economic reality does not prevent the defendant from being sentenced in accordance with his culpability.

Although the application of the economic reality doctrine has been discredited within the calculation of intended loss, the principle continues to serve an important function in sentencing, concerning whether a departure from the GSR computed under § 2B1.1 is warranted.\textsuperscript{107} The commentary to § 1B1.3 authorizes an evaluation of the relationship between the risk of harm and the intended loss calculated under § 2B1.1:

\begin{quote}
If [ ] the guideline refers only to . . . actual, attempted or intended harm (e.g., § 2B1.1 . . . ) the risk created enters into the determination of the offense level only insofar as it is incorporated into the base offense level. Unless clearly indicated by the guidelines, harm that is merely risked is not to be treated as the equivalent of harm that occurred.\textsuperscript{108}
\end{quote}

This application note explains that where the creation of risk is not adequately accounted for in the offense level computed under the applicable guideline, an upward departure may be appropriate.\textsuperscript{109} An upward departure may take place only after the

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\textsuperscript{107} See McBride, 362 F3d at 375; Stockheimer, 157 F3d at 1089; USSG § 2B1.1 cmt n 19 (2009).
\textsuperscript{108} USSG § 1B1.3 cmt n 5 (2004).
\textsuperscript{109} Id. See also USSG § 2B1.1 cmt n 19(A)(iv) (2009) (noting that an upward departure

amount of loss is calculated under the offense guideline and a defendant’s offense level is determined.  

In this regard, the Sixth Circuit has observed:

Where sentencing is based largely or solely on intended loss, a downward departure may be warranted under the “economic reality” principle. . . .

A court should therefore consider whether there was any reasonable possibility that the scheme could have caused the loss the defendant intended. . . . [T]hose 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 by a departure.

Hardly ever do courts addressing sentencing issues in fraud schemes refer to the directive found in § 1B1.3 as to the treatment of risk, despite the fact that the application note concerns the fraud guideline specifically.  Rather, courts discuss the propriety of a departure from the offense level determined under § 2B1.1 by looking into the more visible commentary accompanying § 2B1.1, which provides departure considerations, or the extensive guidance on grounds for departure found in § 5K2.0.

It is also important in assessing the approach to calculating intended loss taken by the First, Seventh, and Eighth Circuits—focused on the amount at risk—to note that these courts do not misread the Guidelines’ specifications regarding the treatment of risk. Instead, these courts recognize that § 2B1.1’s guidance on
the calculation of intended loss does not mention the amount at risk or the possible loss.\textsuperscript{114}

C. Optimal Outcome: Determining the Amount at Risk

There are significant advantages to an objective approach, measuring the amount put at risk by the defendant's scheme. First, this approach is wise to hold it immaterial that a defendant claims to have intended that the loans be repaid, where it is clear that the defendant intended to leave lenders with loans that are riskier and less valuable than the lenders thought.\textsuperscript{115} Second, the task of ascertaining reliable evidence that a defendant did or did not truly intend to inflict a particular loss is one of the more troublesome aspects of the intended loss inquiry. By the time he reaches trial, no defendant has an incentive to tell the court about the magnitude of the loss he was hoping would come about, a figure that should correspond to the defendant's true motive of gain.\textsuperscript{116} Although there is an argument to be made that it is preferable to assess intended loss by examining what a defendant subjectively intended, in order to sentence each defendant in accordance with the notion that culpability, too, is subjective, the adverse incentives produced by this standard suggest a more objective approach.

These advantages of an objective approach complement one another. It is fairly straightforward to determine that a defendant intended to leave a lender with unfavorable loans, based on objective evidence of the defendant's actions from the outset of the fraud, and upon finding that such was the situation, it does not seem problematic to infer that an amount of loss was intended; this approach relieves a sentencing court from an investigation into a defendant's subjective intent.

Related to this is the matter of determining the point in time from which to measure intended loss; the concept of intended loss seems to take on the most accurate and sensible meaning when the inquiry looks back to the outset of the fraud, before the

\textsuperscript{114} See Stockheimer, 157 F3d at 1090 ("The operative concept in determining the offense level is simply the 'intended loss.' The only hint of the relevance of economic reality in the text of the guidelines and commentary is in the provision allowing a downward departure for transparently bogus schemes.") (emphasis in original).

\textsuperscript{115} See Carter, 412 F3d at 869.

\textsuperscript{116} See United States v Moored, 38 F3d 1419, 1429 (6th Cir 1994) (assessing the presupposition that "all defendants charged with fraud . . . indicate that they intended to pay the money back," and holding that the use of intended loss is proper when there is sufficient evidence that the defendant "did not intend to repay the loan" or "had no realistic means to repay the loan").
actual results have occurred. Intended loss measures the defendant's culpability at the time of the criminal activity: "[The amount of risk] measures the gravity of his crime; that he may have hoped or even expected a miracle that would deliver his intended victim from harm is both impossible to verify and peripheral to the danger that the crime poses to the community." This approach makes it irrelevant that a defendant may not have intended to cause a particular amount of loss. Even if a defendant hoped that his scheme would continue indefinitely and would inflict only a small loss, the amount at risk in the scheme is presumed to be the intended consequence of the fraud.

Here, it is important to address concerns about measuring the amount at risk. Probability theory and risk modeling provide a useful supplement to the methodology employed by the First, Seventh, and Eighth Circuits in their measurement of risk, confirming that the amount at risk is a quantifiable value. In this objective framework, the concepts of expected value—in this case, expected loss—and risk are crucial. Probability theory provides for the computation of these values; the expected value, or the mean, is calculated by the sum of each possible outcome multiplied by its respective probability, while risk may be contemplated as "a measure of uncertainty" or, more appropriately in this context, "a measure to capture the potential of sustaining a loss."

Risk modeling addresses both expected and unexpected losses. While expected losses are merely average, day-to-day losses, unexpected losses are characterized by low frequency and

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117 See United States v Nichols, 229 F3d 975, 979 (10th Cir 2000) ("The reason the intended loss figure is used, even if it is significantly greater than actual loss, is to measure the magnitude of the crime at the time it was committed."). But see United States v Calkins, 2006 WL 2430999, *3–4 (6th Cir) (reducing the amount of loans by the fair market value of collateral at the time of sentencing to compute intended loss).
118 United States v Brownell, 495 F3d 459, 463 (7th Cir 2007). See also Miller, 588 F3d at 566 (explaining that an interpretation of intended loss as consisting of only intended foreclosure loss is too narrow); Innarelli, 524 F3d at 290 ("[T]he Guidelines anticipate that the defendant will be punished commensurate with the degree of loss he reasonably expected to occur as long as this amount is greater than the victims' actual loss—including where the victims actually inured no loss at all.");, citing McCoy, 508 F3d at 79.
119 Miller, 588 F3d at 566 ("[A] determination that there is intended loss attributable to [the defendant] is not precluded even though ... he intended that all of the loans be repaid."); Lane, 323 F3d at 590 (disregarding the defendant's argument that he did not intend to cause a loss, since only a small amount of the loan was secured by property).
120 See Lauer, 148 F3d at 768.
high severity, and loan application fraud falls into the latter category. One mechanism utilized by banks to protect themselves against fraud losses is to obtain insurance against this risk.\textsuperscript{122} Risk models and insurance models set forth specific formulas for assessing expected losses and unexpected losses for lenders in the mortgage industry.\textsuperscript{123} These models provide an effective framework for assessing the potential consequences of loan application fraud, demonstrating that it is feasible to measure the amount at risk, as proposed.

CONCLUSION

In assessing intended loss under § 2B1.1, for purposes of sentencing a defendant convicted of mortgage fraud, the authority of the circuit courts is in disarray. When the courts recognize the disagreement, they often characterize it as a dispute between a subjective and objective inquiry; however, it seems more accurate to express the conflict using the distinction between actual intent and constructive intent. This more coherent explanation of the conflict also provides a basis for an inquiry into the amount at risk. A measurement of the amount at risk is not only a true representation of intended loss in mortgage fraud cases, but it is also a workable inquiry that can be conducted uniformly in sentencing defendants convicted of mortgage fraud.

