ALM | LAW.COM

COMMENTARY

Calculating the Cost of Crime: The Significance of Loss Determination in White-Collar Federal Cases

The considerations for determining the financial loss in a federal criminal matter are analogous to those a practitioner may employ in other issues requiring measuring a financial loss (i.e., damages in civil litigation).

May 09, 2024 at 10:05 AM

Litigation

By Edward Waddington and Jesse LaGrossa | May 09, 2024 at 10:05 AM

Introductory Comments

Accurately determining the financial losses in white-collar federal criminal matters is vital to all parties as the loss may impact court-ordered restitution and the length of any incarceration imposed by the court. The guidelines manual issued by the U.S. Sentencing Commission (often referred to as the federal sentencing guidelines), first enacted by the U.S. Congress in 1987 provides recommendations that judges may consider when imposing a sentence. These guidelines correlate in part to the amount of loss attributable to the alleged misconduct with the length of a sentence; hence, the greater the loss, the longer the sentence. While federal judges may consider the sentencing guidelines, they are not obligated to adhere to them— hence the term "guidelines."

The considerations for determining the financial loss in a federal criminal matter are analogous to those a practitioner may employ in other issues requiring measuring a financial loss (i.e., damages in civil litigation). As any disputed loss will be litigated in federal court, the loss analysis must comply with applicable professional standards and considerations for "expert" testimony outlined in Federal Rule of Evidence 702 (FRE 702). FRE 702 provides a properly qualified expert may testify, if:

- The testimony is based upon sufficient facts or data.
- The testimony is the product of reliable principles and methods.
- The expert's opinion reflects a reliable application of the principles and methods to the facts of the case.

A 2022 federal case captioned *United States v. Porat* illustrates the importance of adhering to criteria set forth in FRE 702 when determining the amount of loss attributable to a defendant's alleged fraudulent conduct.

The *Porat* matter involved the dean of a well-known business school who was convicted of conspiring with others to fraudulently inflate his school's rankings in U.S. News & World Report. The identified victims of Porat's fraudulent activities were those students and donors who relied on and made decisions based on the school's fraudulently inflated ranking.

At trial, the prosecution presented testimony from an Federal Bureau of Investigation (FBI) special agent who "made a rough estimate of the increase in gross revenue attributable to the fraud. Multiplying by $60,000 the number of students above the pre-fraud baseline for each program." Using this approach, the special agent calculated that the university's

tuition revenue increased by slightly less than $40 million due to the fraud (i.e., "gross revenue" approach).

After the trial but before sentencing by the trial court, the prosecution abandoned its $40 million loss calculation and decided "the appropriate measurement of loss under Section 2B1.1(b)(1) of the sentencing guidelines was $5.475 million, which represented the combined settlement amounts of the two class action lawsuits" brought against the university by its students. Accordingly, at sentencing, the prosecution presented its arguments that Porat should be sentenced based upon a $5.475 million loss (i.e., "class action settlement" approach). In a memorandum dated March 16, 2022, the trial judge provided a detailed narrative explaining his rationale for rejecting both loss approaches presented by the prosecution. As stated by the trial judge:

"The government did not prove by a preponderance of the evidence facts that permitted the court to reasonably estimate the amount of loss associated with Porat's crimes."

In rejecting the "gross revenue" approach, the judge explained:

"When a fraud victim receives something of value from the perpetrator, the victim's loss is not the total amount of money he paid the fraudster, but 'the difference between the value he or she gave up and the value he or she received.'"

Addressing the "class action settlement" approach, the judge noted:

"No evidence ties the settlement amounts-either the lump sum payments or the average distributions to class members-to the actual loss suffered by students. In fact, both the nature of the class action settlement approval process and the specifics of the litigation … suggest the resulting settlements were not tethered to the actual, economic loss suffered by Porat's victims.

The court cannot accept the settlement as a reasonable estimate of the victims' loss on little more than faith."

The judge concluded that "Given those realities, it would be unfair to uncritically accept a settlement between other parties … as a presumptively reasonable measure of Porat's criminal liability." He also noted "The government put forward no evidence to explain how the settlement amounts were calculated or why they represent the 'concrete, monetary harm' experienced by students who enrolled in the online or part-time MBA programs relying on those programs' inflated rankings."

The prosecution argued in favor of the $5.475 million class action settlement, contending the amount was "substantially less than the nearly $40 million in extra tuition revenues" presented by the FBI special agent at trial. The judge rejected this argument noting:

"That extra tuition revenue represents only half the equation. The students' actual loss was the difference between what they paid and what they received. Without any information about the value of what they received; it is impossible to tell whether the settlements are more, less or a 'reasonable estimate' of that difference."

Ultimately, the judge concluded that using the "class action settlement" "amount-or any fraction of it-to the aggregate actual loss … may have been convenient, and certainly easier for the mathematically disinclined, to rely on the settlement figures, but it would not have been reasonable to do so."

Prosecution arguments for other methods to calculate the fraud loss were deemed by the judge as "academic. There is no other evidence in the record with which the court could make a reasonable estimate of the victims' loss, either actual or intended." This included the prosecution's argument that Porat's "gain" should be used as an "alternative measure of loss."

Again, the judge rejected the prosecution argument, stating "the government failed to prove facts that would have enabled the court to calculate gain."

The trial judge rejected an effort by defendant to contend that the prosecution's difficulties in calculating the amount of loss meant there was no loss associated with Porat's alleged misconduct. The judge rejected the defendant's assertion, citing evidence that the diploma the students received was "worth less than what students paid for it."

Lessons Learned and Closing Comments

The judge's memorandum detailed the trial court's consideration of multiple loss concepts including speculation, reasonable estimation, causal connections and sufficiency of evidence when preparing financial loss calculations. It also underscored the importance of establishing an admissible record, whether at trial or during related proceedings, that provides an appropriate foundation for any financial damage calculations that might be presented. As the judge stated, the prosecution did not provide sufficient evidence to support the fraud losses being asserted causing its loss calculations to be unrelated to the alleged misconduct or speculative.

As financial damage experts and advocates for our opinion, we and counsel are responsible to for taking appropriate measures to ensure that our analyses are supported by relevant admissible evidence. This little reminder may be helpful, given recent revisions to FRE 702.

Edward Waddington *is a partner in Marcum LLP's Philadelphia office and a member of the valuation, forensic and litigation services practice. He came to Marcum in 2015 via the firm's merger with Smart Devine (formerly Nihill & Riedley), a leading full-service accounting firm in Philadelphia.*

Jesse LaGrossa *is a senior manager in the firm's Philadelphia office and a member of the valuation, forensic and litigation services group. He joined the firm after serving as an audit and assurance manager with a Philadelphia-based public accounting firm.*

NOT FOR REPRINT