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The Impact of United States v. Banks on Securities and Commodities Fraud Sentencing

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The U.S. Sentencing Guidelines ("Guidelines") provide federal courts with a framework for sentencing criminal defendants based on the seriousness of the offense and the defendant's criminal history. While the Guidelines are comprehensive, courts often turn to the accompanying Commentary to provide direction on how to interpret and apply the provisions. For some Guidelines provisions, the Commentary can be a significant factor in defining the scope of the provision.

In *United States v. Banks*, the Third Circuit Court of Appeals substantially limited the ability of courts to use the Commentary to calculate loss amount by holding that, unless a provision in the Guidelines is "genuinely ambiguous," courts may not rely upon the Commentary for their interpretation.[1] In *Banks*, the court applied this principle to preclude any reliance on "intended loss"—which is a term included only in the Commentary—because the guideline only refers to "loss," a term that the court found unambiguously means only actual loss.

If adopted by other circuits, the reasoning in *Banks* could severely limit the scope of other Guideline provisions, potentially bringing about a sea change in how certain federal sentences are calculated. One area where *Banks* may have a significant impact is in securities and commodities fraud prosecutions, where prosecutors frequently use either "intended loss" or "gain" as a substitute measure when the actual loss cannot be reasonably determined. Like intended loss, however, the use of gain as a proxy for loss is only found in the Commentary. Its substitution therefore would be barred by the reasoning in *Banks*, resulting in lower sentences for many defendants. In some cases, if the actual loss amount cannot be calculated and the resulting potential sentence is sufficiently low, prosecutors may even decide to forego charges in cases they previously would have pursued.

I. The *Third Circuit's United States v. Banks* Opinion

Courts generally defer to an agency's reasonable interpretation of its own genuinely ambiguous regulation—this is known as *Auer* deference.[2] Recently, in *Kisor v. Wilkie*, the Supreme Court held that *Auer* deference applies only if two prerequisites are met: (1) there must be a "genuine ambiguity in an agency's regulation," and (2) the "character and context of an agency's interpretation must fall within the regulation's zone of ambiguity."[3] Thus, no deference is owed to the agency's interpretation if the regulation is not genuinely ambiguous.

In *Banks*, the defendant was convicted at trial of four counts of wire fraud and one count of aggravated identity theft in connection with a scheme to make fraudulent transfers and thereby defraud a bank.[4] Although the defendant attempted to execute the transfers and intended to cause $264,000 in losses, none of the funds was actually transferred and the bank did not suffer any actual losses. Relying upon the Commentary, the district court calculated the loss amount based upon the intended loss of $264,000, and imposed a 12-level enhancement. By relying upon intended loss instead of actual loss, the court substantially raised the defendant's base offense level from a 7 to a 19.[5]

The Third Circuit court rejected the use of the Commentary to define the meaning of loss to include intended loss under Section 2B1.1 because it did not satisfy the prerequisites cited by *Kisor*.[6] Reviewing dictionary definitions, the court found that the term "loss" was unambiguous, and that it should be read only to cover actual loss. Therefore, the court held the Commentary should not receive *Auer* deference in this instance, and that courts cannot rely on intended loss to calculate sentences.[7]

While *Banks* is binding only on courts within the Third Circuit, there are signs that other courts may adopt its holding. For example, the Eleventh Circuit recently applied the reasoning in *Banks* to find that the definition of "controlled substance offense" was unambiguous, and therefore the district court erred by impermissibly expanding it to include "aiding and abetting, conspiring, and attempting to commit such offenses."[8] However, several circuit courts, including the Fourth, Fifth, Sixth, and Seventh Circuits, have rejected applying *Kisor* to the Guidelines, resulting in a circuit split that may need to be resolved by the Supreme Court.

II. Impact on Securities and Commodities Fraud Sentences

One area where *Banks* may have a substantial impact is in securities and commodities fraud prosecutions. In such cases, it can be very difficult to determine the amount of actual loss suffered by victims. For example, where there is a fraud affecting the market, there may be a high number of victims and it may be hard to identify individual investors who lost money. Moreover, because markets change due to a multitude of other factors, it can be impossible to isolate and identify the specific loss caused by the fraud, as opposed to other factors. Issues of documentation and proof may further complicate the ability of the government to establish actual loss.

Accordingly, prosecutors often rely upon intended loss as a proxy for actual loss in securities and commodities fraud cases. This practice has allowed the government to calculate large loss amounts and seek high guidelines sentences where actual loss is incalculable or impractical to determine. For example, in *United States v. Allen*, the defendants were charged with manipulating the LIBOR rate.[9] The actual loss was difficult to calculate because it would have required determining not only how the fraud impacted the rates, but also how each victim was financially impacted by the artificially inflated rate. To avoid this burden, the government instead turned to intended loss—basing its calculation on a sample of requests and assumptions about the degree to which the defendants intended to change the rate. The court relied upon these assumptions to calculate an intended loss of $1.149 million dollars, which it used to sentence the defendants.

Moreover, in some securities and commodities fraud prosecutions, there may not be any actual losses. For example, in a market manipulation scheme, the market participants may realize losses on one side of a trade, but have gains on the other, resulting in no actual losses. This was the case in *United States v. Vorley*, where defendants were charged with spoofing, an allegedly fraudulent and manipulative trading practice involving commodities.[10] The court acknowledged that victims might not have suffered any actual loss, because the same victim could realize a gain on one side of a spoof and a loss on a different side. In this case, even though investors may not have experienced any actual loss, the government was able to seek a much higher sentence based on intended loss.

Using gain as a substitute for actual loss is another tool prosecutors frequently employ to calculate loss in securities and commodities fraud cases. Courts have permitted the use of gain where determining actual loss would impose an insurmountable logistical burden on the prosecution because the scheme is too "complex, involving thousands of anonymous trades executed across multiple exchanges with numerous counterparties."[11] For example, in *United States v. Sarao*, the defendant was accused of manipulating markets that allegedly caused a global "Flash Crash."[12] The government highlighted the difficulty in approximating actual loss "because the defendant's Spoof Orders *may* have affected thousands of counterparties and other market participants." The court thus relied on the defendant's personal gain from the scheme to calculate the estimated loss used for the sentencing calculation.[13]

By requiring prosecutors to prove actual loss for sentencing defendants in securities and commodities fraud cases, *Banks* may substantially reduce the prison sentences faced by such defendants.

III. The Impact of *Banks* on Prosecutor's Charging Decisions

After *Banks*, prosecutors in the Third Circuit will have to make a difficult choice when deciding to charge a securities and commodities fraud scheme.

Cases where there are no actual losses may no longer be attractive to prosecutors if the potential prison sentences are low. For example, in *Vorley*, the actual losses were probably zero.[14] The applicable Guidelines range based on zero loss would have been imprisonment of 8 to 11 months, rather than the 57 months imposed using intended loss. In *United States v. Robson*, another LIBOR manipulation case, the prosecutor was unable to prove actual losses. Using gain, the court imposed a sentence of 33 to 51 months imprisonment.[15] Forced to prove actual loss, the likely sentence could have been as low as six months. As was the case in *Allen*, the difference between intended loss and zero actual loss can be the difference between years in prison and a suspended or six month sentence.[16]

Even in cases where there are actual losses, the burden of proving those losses may be too onerous for prosecutors, requiring the use of experts and analysis of reams of data. Indeed, proving actual loss could result in prolonged hearings and testimony involving expert opinions, which can vary widely requiring extensive review and analysis by the court. For example, in *United States v. Olis*, a securities fraud case, the government's expert witness estimated loss to be between $161 million and $714 million dollars. The defendant contested this calculation with its own expert, and the court ultimately determined that actual loss could not be calculated with reasonable certainty.[17] While a court at sentencing conducts fact-finding based on a preponderance of the evidence and need only make a "reasonable estimate" of the actual loss, in the complicated universe of securities and commodities markets, courts may not currently have the expertise to make consistent or fair determinations when faced with such a "battle of the experts."

IV. Takeaways

The reasoning in *Banks* greatly limits the ability of federal prosecutors to use intended loss and gain to seek much higher sentences where actual losses are low or difficult to calculate. As more courts consider *Banks* and seek to apply *Kisor* to the Guidelines, it will be interesting to see how prosecutors react. Will prosecutors continue to charge securities and commodities cases involving little or no actual losses, or where such losses are very difficult to determine or prove? Even if prosecutors bring such cases, however, the *Banks* reasoning will likely limit—potentially significantly—their leverage when requesting cooperation and negotiating plea agreements. Defendants should be prepared to demand that federal prosecutors prove actual losses, and if necessary, retain experts to prove that actual losses are small or even nonexistent.

This is true not only for individual defendants, but also corporate entities that are the targets of a securities or commodities fraud investigation. Even where companies are under pressure to enter into a corporate resolution with the Department of Justice, as a matter of fairness and to prevent similarly situated companies from being treated differently, they should push prosecutors to rely upon actual loss when determining the appropriate penalty.

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[1] United States v. Banks, No. 19-3812 (3rd Cir. 2022).

[2] United States v. Auer, 519 U.S. 452 (1997).

[3] Kisor v. Wilkie, 139 S. Ct. 2400 (2019).

[4] *Banks*, *supra* note 1 at * 7-8.

[5] *Id.*

[6] *Id*. at *16.

[7] *Id*. at *18-19.

[8] United States v. Dupree, 2023 WL 227633 (11th Cir 2023).

[9] United States v. Allen, 14 Cr. 272 (S.D.N.Y.).

[10] United States v. Vorley, 18 Cr. 0035 (N.D. Ill.).

[11] United States v. Coscia, 866 F.3d 782, 801 (7th Cir. 2017).

[12] United States v. Navinder Singh Sarao, 15 Cr. 75 (N.D. Ill.)(emphasis added).

[13] *Id.*

[14] *Vorley*, *supra* note 9.

[15] United States v. Robson, No. 14-cr-272 (S.D.N.Y.)

[16] *Allen*, *supra* note 8.

[17] United States v. Olis (Olis II), No. H-03-217-01, 2006 WL 2716048 (S.D. Tex. Sept. 22, 2006).