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Case Study: US V. Woolf Turk

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Law360, New York (December 20, 2010) -- The U.S. Court of Appeals for the Second Circuit recently issued a sentencing decision that shuts the door on an argument that defendants in mortgage fraud-related cases had hoped would dramatically reduce their exposure under the United States Sentencing Guidelines. In United States v. Woolf Turk, No. 09-5091-cr (2d Cir. Nov. 30, 2010), the court held that a New York-based real estate developer found guilty of defrauding over 70 individual investors in a phony collateral scheme should be held accountable under the United States Sentencing Guidelines for the full $27 million in unpaid loans made to her by those investors.

The Second Circuit rejected the defendant's argument — based on two securities fraud cases, United States v. Rutkoske, 506 F.3d 170 (2d Cir. 2007), and United States v. Ebbers, 458 F.3d 110 (2d Cir. 2006), as well as a mortgage fraud case from the Eighth Circuit Court of Appeals, United States v. Parish, 565 F.3d 528 (8th Cir. 2009) — that the loss attributable to her fraud should be zero, and the guidelines range significantly lower, because the collapse of the real estate market, and not her actions, caused the investors' losses.

The court's decision clarifies that, in criminal mortgage fraud cases, the loss calculation for purposes of determining the offense level under the guidelines is based on the value of the unpaid loan principal, and not the decline in value of the promised collateral. Thus, where the value of that collateral is zero because of unforeseen market conditions, the amount of the loss will not be reduced. This decision has significant implications for defendants involved in mortgage fraud cases who seek to challenge federal sentencing enhancements based on the loss associated with that fraudulent conduct.

The Second Circuit's Decision

Ivy Woolf Turk and her business partner owned a Manhattan-based real estate development company. Between 2003 and 2007, they undertook a plan to renovate, construct or purchase a number of residential buildings in upper Manhattan and Nassau County.

To finance these activities, Woolf Turk and her partner solicited loans from approximately 70 individual investors, many of whom used their retirement savings to fund their investments, with the promise that these individuals would hold recorded, first mortgages on the properties. But Woolf Turk and her partner never recorded these mortgages and, instead, obtained secured loans from a number of banks for the same properties without notifying the investors and, in at least one instance, forging documents that purported to show the investors' recorded mortgages.

Woolf Turk and her partner were arrested in 2007, shortly after the fraud was uncovered. She subsequently pled guilty to a single count of conspiracy to commit mail and wire fraud in violation of 18 U.S.C. §§ 1341, 1343 and 1349.

In November 2009, United States District Judge Naomi R. Buchwald sentenced Woolf Turk to 60 months' imprisonment and ordered her to pay over $29 million in restitution (the amount of loss plus interest) to the victims of the scheme. This sentence was a downward departure from the guidelines range, which Judge Buchwald had calculated as 121 to 151 months' imprisonment.

In reaching that range, Judge Buchwald found that the amount of loss properly attributable to Woolf Turk under § 2B1.1(b)(1) of the guidelines was the full amount of the unpaid loans made to Woolf Turk by her victims, $27,184,750, without any reduction to account for the decline in the market value of the collateral.[1]

As white collar practitioners are aware, the loss ultimately attributed to a defendant in large part drives the Guidelines sentencing range, particularly in the case of large-scale financial frauds. And "actual loss" for purposes of Section 2B1.1(b)(1) is defined as "the reasonably foreseeable pecuniary harm that resulted from the offense."[2]

At the same time, the guidelines include a number of provisions that defendants can use to reduce the loss amount. For example, the total loss amount may be reduced if victims have had an opportunity to recover some of the amounts they lost as a result of the fraud. Application Note 3(E)(ii) of the guidelines provides that a district court should credit against the loss "the amount the victim has recovered at the time of sentencing from disposition of the collateral, or ... the fair market value of the collateral at the time of sentencing."[3]

In Woolf Turk's case, however, by the time of sentencing in late 2009, the value remaining in her company's investment properties had declined so precipitously that it was sufficient to cover only the secured claims of the banks that had lent her company money and the bankruptcy fees and other expenses.

As a result, the district court found that Woolf Turk's actions caused investors to lose almost the entirety of the over $27 million in loans they had made to her. Because the amount of the loss was greater than $20 million and less than $50 million, this led to a 22-level increase to her base-level offense of 7.[4] The corresponding increase in the guidelines calculation would have been significant. A 22-level enhancement to a 7-level base offense increases the recommended sentence from no more than six months to over seven years.[5]

On appeal, Woolf Turk argued that the district court should have reduced the loss amount by the value of the properties at the time she claimed her fraud was revealed in May 2007. At that time, she contended, the losses sustained by the investors would have been zero.

She noted that her partner and she had had an agreement in principal for an unrelated hedge fund to purchase their company's assets at a price that would have been sufficient to compensate fully the individual investors. Any subsequent decrease in the value of the collateral, Woolf Turk argued, was due to the collapse of the real estate market, and not her fraudulent actions, and was therefore not a "reasonably foreseeable pecuniary harm" that should factor into the loss calculation.

She further noted that the Eighth Circuit Court of Appeals in United States v. Parish had adopted just such a test when the court held that the "appropriate test" for calculating the amount of loss suffered by mortgage lenders "is not whether market factors impacted the amount of loss, but whether the market factors and the resulting loss were reasonably foreseeable."

Woolf Turk also premised her argument on the Second Circuit's loss calculation decisions in the context of securities fraud actions, United States v. Rutkoske and United States v. Ebbers, as well as the decision of the Fifth Circuit Court of Appeals in United States v. Olis, 429 F.3d 540 (5th Cir. 2005). Those cases recognized that a district court calculating loss for purposes of sentencing in a securities fraud action must determine "the extent to which a defendant's fraud, as distinguished from market or other forces, caused shareholders' losses" and exclude the amount of losses attributable to sources other than the defendant's conduct from the total loss amount.[6]

Woolf Turk argued that the same analysis should have been applied in her case, and the district court erred when it failed to factor in extrinsic market forces in calculating loss. She further emphasized that her argument was not based on Application Note 3(E)(ii), but instead on the fact that the government could not show that her conduct was the proximate cause of the investors' losses in the first place.[7]

At the district court level, Woolf Turk's argument was supported by the National and New York State Associations of Criminal Defense Lawyers, as well as the New York Council of Defense Lawyers.

In an amici curiae brief submitted prior to sentencing, these organizations argued that failing to determine whether market events other than the defendant's conduct in mortgage fraud cases proximately caused the victims' losses would result in a "fundamentally disparate treatment of defendants in fraud cases" between defendants convicted of securities fraud, as in Rutkoske and Ebbers, and other offenses under § 2B1.1 of the Guidelines.[8] The amici maintained that no such distinction is found in the guidelines, and this interpretation could result in "harsh and lengthy sentences that undermine the legitimacy of the sentencing system and punish defendants well beyond that which justice requires."[9]

In its response, the government emphasized that, under the express language of Application Note 3(E)(ii) of the guidelines, the value of any collateral to be applied against victims' losses is determined "at the time of sentencing." And, at the time of sentencing in this case, the victims had been able to recover only a small fraction of their over $27 million in loans to Woolf Turk and her partner. The government further argued that Woolf Turk's reliance on securities fraud cases was "inapt" because "a loan secured by collateral is fundamentally different from stock."[10]

In a decision written by Judge Peter W. Hall, the Second Circuit emphatically rejected Woolf Turk's reasoning and affirmed the district court's sentence in all respects.[11] The court concluded that a decrease in the value of the collateral is not part of the "reasonably foreseeable" analysis.

Citing favorably a district court opinion from the Eastern District of Virginia, United States v. Mallory, 709 F. Supp. 2d 455 (E.D. Va. 2010), the court stated that “the only loss that need have been foreseeable is the loss of the unpaid principal.”[12] The court reasoned, “[i]t cannot possibly be the case that the decline of the collateral’s value must be foreseeable in order to calculate loss amount if the offset is set as of the time of sentencing, as the defendant can never know what the collateral’s value will be at that arbitrarily chosen time.”[13]

The court continued, “all of Woolf Turk’s arguments about the extrinsic forces that caused the value of the collateral to decline are simply irrelevant — they may or may not be true, and she might have earned a credit against loss if they had not occurred, but she may not invoke them to insulate her from responsibility for the loss she caused, namely, the loss of the unpaid loan principal.”[14]

While the Second Circuit acknowledged that Woolf Turk’s argument found “some support” in the Eighth Circuit’s decision in Parish, the court ultimately declined to follow Parish because “it conflates the initial calculation of loss (where foreseeability is a consideration) with the credits against loss available at sentencing (where it is not).”[15]

The Second Circuit also distinguished its decisions on loss calculation in the context of securities fraud offenses, Rutkoske and Ebbers. It explained that the import of its decision would not be to “limit the application of the causation requirement to securities cases.” Instead, the court explained that the error in Woolf Turk’s argument “stems from her failure to recognize that the item of value lost by her victims was the unpaid principal of the loans, not the buildings themselves.”

The court then distinguished between the loss suffered by shareholders in a securities fraud action and the loss suffered by Woolf Turk’s victims: “A loan cannot be compared to a stock because a stock is owned outright, with the assumption of upside benefit and downside risk, while a loan is merely the exchange of money for a promise to repay, with no assumption of upside benefit. At any given time, the buildings in this case were nothing more than insulation against loss.”[16]

Implications of the Decision

Mortgage fraud investigations and prosecutions show every sign of increasing over the next few years. The Second Circuit’s decision cabins one important argument in favor of a reduced sentence for defendants in these cases by restricting their ability to argue that the decline in the real estate market was the real cause of victims’ losses.

The Second Circuit’s distinction between mortgage lenders and securities investors may also impact sentences in other fraud actions where the defendant might otherwise have been able to argue that his or her fraudulent acts were not the cause of the loss. Because this analysis could result in longer sentences for certain types of fraud offenses, it is an important factor to bear in mind when assessing whether to negotiate a plea or go to trial in fraud cases outside the securities context.

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Marcus Asner was involved in the prosecution of the Woolf Turk matter while he was serving as an assistant U.S. attorney in the Southern District of New York, but took no part in the appeal.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media, publisher of Law360.

[1] Under Section 2B.1.1(b)(1) of the Sentencing Guidelines, the offense level for a fraud offense (as well as for many other financial crimes) is calculated in part based on amount of loss attributable to the fraud. United States Sentencing Commission, Guidelines Manual, §2B1.1(b)(1) (Nov. 2010).

[2] USSG §2B1.1, comment. (n.3(A)(i)).

[3] USSG §2B1.1, comment. (n.3(E)(ii)).

[4] USSG § 2B1.1(b)(1)(L).

[5] USSG Sentencing Table.

[6] See Rutkoske, 506 F.3d at 179; Ebbers, 458 F.3d at 128; Olis, 429 F.3d at 548-49.

[7] Appellant's Reply Br. 6-10.

[8] Amici Curiae Brief of The National Association of Criminal Defense Lawyers, The New York State Association of Criminal Defense Lawyers, and The New York Council of Defense Lawyers 9 (Oct. 19, 2009).

[9] Amici Curiae Br. 20.

[10] Appellee's Br. 26.

[11] Circuit Judge Robert A. Katzmann and District Judge Barbara S. Jones (sitting by designation) also sat on the panel.

[12] Slip. Op. 12.

[13] Slip Op. 14.

[14] Slip. Op. 14.

[15] Slip. Op. 14-15.

[16] Slip Op. 15.