NOTES

COMMERCIAL LAW—MAINTENANCE OF COMPENSATING BALANCES INDICTABLE OFFENSE UNDER 18 U.S.C.A. §656

In *United States v. Mann*,[1] the United States Court of Appeals for the Fifth Circuit upheld the validity of an indictment[2] which had charged defendant Mann, chief executive officer of the First National Bank of Waco, Texas, together with co-defendant Bank of the Southwest with conspiracy[3] to willfully misapply the funds of Waco, through the maintenance of a non-interest bearing compensating balance at Southwest in return for a loan to Mann at preferential interest rates, in violation of 18 U.S.C.A. §656.[4] The district court had dismissed the indictment for insufficiency and the United States appealed.

The conspiracy evolved due to Mann's desire to acquire the controlling interest of the Waco bank. By maintaining a compensating balance at Southwest,[5] Mann not only received a preferential interest rate on his loan,[6] but also caused the Waco bank to forego interest money that it otherwise would have received.

The federal statute involved in this case is quite old; the forerunner of 18 U.S.C.A. §656 was first promulgated in the late 19th century.[7] Using §656, however, to attack the maintenance of compensating balances as a

1. 517 F.2d 259 (5th Cir. 1975).
2. *Id.* at 262.
3. 18 U.S.C.A. §371 (Rev. 1966):
   If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, . . . each shall be fined not more than $10,000 or imprisoned not more than five years, or both.
4. 18 U.S.C.A. §656 (Rev. 1966):
   Whoever, being an officer, director, agent, or employee of, or connected in any capacity with any Federal Reserve Bank, member bank, national bank, or insured bank, . . . embezzles, abstracts, purloins, or willfully misapplies any of the monies, funds, or credits of such bank or any monies, funds, assets, or securities entrusted to the custody or care of such bank, . . . shall be fined not more than $5,000 or imprisoned not more than five years or both . . . .
5. Mann deposited $4,000,000 of Waco's funds in a non-interest bearing account at Southwest in return for a loan from Southwest totaling $4,000,000. Mann intended to use the loan proceeds to acquire controlling interest in Waco. 517 F.2d at 263.
6. Mann's loan from Southwest was listed at 3% per annum, notwithstanding the fact that Southwest's prime lending rate was at 8 1/2% per annum. This lower rate resulted in a $460,000 savings for Mann within a two year period. 517 F.2d at 263.
7. *See* REV. STAT. 5209, p. 1007 (1873-74). *See also* United States v. Britton, 107 U.S. 655, 2 S.Ct. 512, 27 L.Ed. 520 (1883).

willful misapplication of bank funds has evolved only since the promulgation of Banking Circular No. 31.[8] The circular was sent to the presidents of all the national banks. It advised them that there were no cases "at the present time" construing the use of compensating balances to obtain a preferential interest rate loan to be a misapplication of bank funds under the criminal statutes, yet some such situations might exist that would warrant prosecutive action.

Even though the activities being attacked by the section may be relatively new, the essential elements of a substantive violation of 18 U.S.C.A. §656 have been clearly delineated.[9] Any indictment must contain the elements of the offense charged, fairly inform the defendants of the charge against which they must defend, and if a second action is brought, it must enable the defendants to plead a prior conviction or acquittal as a bar to that second action.[10] But more specifically, for an indictment to be sufficient to allege a violation of §656, it must include an allegation: (1) that the accused was an officer, director, etc. of a bank; (2) that the bank was connected in some capacity with a national or federally insured bank; (3) that the accused willfully misapplied the money, funds, etc. of said bank; and (4) that the accused acted with intent to injure or defraud said bank.[11] In a prosecution under 18 U.S.C.A. §656, so long as the offense is set out in the language of the statute, it is not necessary that the indictment set forth the means by which the offense was committed.[12]

Since the promulgation of Banking Circular No. 31 and prior to *Mann*, there has been only one case construing the use of compensating balances in return for loans to bank officials as a misapplication of bank funds in violation of 18 U.S.C.A. §656.[13] The first consideration by an appellate court of such an application of the statute occurred in *United States v. Brookshire*,[14] decided last year by the Tenth Circuit Court of Appeals. The facts of *Brookshire* were strikingly similar to those of the present case. Brookshire, a bank president, in conjunction with another bank, used the same scheme employed by Mann, (*i.e.*, maintenance of a compensating balance in return for a preferential interest rate loan). He was indicted under §656 for willful misapplication of bank funds and was subsequently

8. Comptroller of the Currency, Banking Circular No. 31 (Oct. 1970). *See* 517 F.2d at 269.

9. *See* Garrett v. United States, 396 F.2d 489, 491, (5th Cir. 1968), *cert. denied*, 393 U.S. 952, 89 S.Ct. 374, 21 L.Ed.2d 364 (1968).

10. 517 F.2d at 266, *citing* Russell v. United States, 369 U.S. 749, 763-64, 82 S.Ct. 1038, 1047, 8 L.Ed.2d 240, 250-51 (1962).

11. 517 F.2d at 267. *See* Garrett v. United States, 396 F.2d at 491. But see Ramirez v. United States, 318 F.2d 155, 157-58 (9th Cir. 1963), where the court suggested that intent to injure or defraud need not specifically be alleged because the allegation of willful misapplication sufficiently imports an intent to injure or defraud.

12. United States v. Archambault, 441 F.2d 281, 283 (10th Cir.), *cert. denied*, 404 U.S. 843, 92 S.Ct. 140, 30 L.Ed.2d 78 (1971).

13. United States v. Brookshire, 514 F.2d 786 (10th Cir. 1975).

14. *Id.*

convicted. The court found little merit in the defendant's contention that "willfully misapplies" is unconstitutionally vague and uncertain.[15] Also, since the indictment was set out in the language of the statute, the court had no trouble disposing with an attack on its sufficiency.[16] The defendant claimed a denial of equal protection in that he was wrongfully being singled out to test government theories as to the scope of §656. The court found that this statute did not invidiously discriminate as that considered in *Yick Wo v. Hopkins*,[17] nor was selective enforcement, in itself, a federal constitutional violation.[18] The indictment did not create a new offense through the use of the words "willfully misapplies,"[19] nor was it an attempt to regulate private business through the use of a criminal prosecution.[20] *United States v. Insco*[21] provided little comfort to the defendant due to the fact that the record contained no proof of any open and constant practice by bankers to secure favors through the use of compensating balances. In *Insco* the court reversed the conviction of an unsuccessful candidate for federal office for failing to place an attribution clause on bumper stickers distributed by him, in violation of 18 U.S.C.A. §612. Three factors led the court to this decision: (1) silence in the legislative history of the statute made it unclear whether Congress intended to encompass bumper stickers in the attribution clause requirement; (2) there had been a "universal practice" among candidates of not affixing such clauses to bumper stickers; and (3) the case was the first prosecution ever brought by the justice department. The court felt that Insco had been "lulled into the reasonable impression" that his actions were not criminal. Overall, the court in *Brookshire* concluded: that the indictment was sufficient; that the jury found the necessary intent to convict; and that the defendant had willfully misapplied the funds of his bank in order to obtain a personal favor.[22]

The court in *Mann* was faced with numerous defenses, many similar to the ones set forth in *Brookshire*, which they rejected in upholding the sufficiency of the indictment. In response to the defendant's contentions, the court held that it was not necessary for the indictment to allege that the bank had suffered any loss due to the action of the defendant.[23] Also, the government need not have alleged that the misappropriated funds were converted to the use of the defendants,[24] nor was it necessary for the gov-

15. 514 F.2d at 788, *citing* United States v. Cooper, 464 F.2d 648, 652-53 (10th Cir. 1972), *cert. denied*, 409 U.S. 1107, 93 S.Ct. 901, 34 L.Ed.2d 688 (1973).

16. 514 F.2d at 788, *citing* United States v. Archambault, 441 F.2d 281, 283.

17. 118 U.S. 356, 6 S.Ct. 1064, 30 L.Ed. 220 (1886).

18. 514 F.2d at 789, *citing* Oyler v. Boles, 368 U.S. 448, 456, 82 S.Ct. 501, 506, 7 L.Ed.2d 446, 453 (1961).

19. 514 F.2d at 789.

20. *Id.*

21. 496 F.2d 204, 208 (5th Cir. 1974).

22. 514 F.2d at 790.

23. 517 F.2d at 268, *citing* United States v. Richert, 459 F.2d 352, 354 (5th Cir. 1972).

24. 517 F.2d at 268, *citing* United States v. Fortunato, 402 F.2d 79, 82 (2nd Cir.), *cert.*

ernment to allege that the misapplication was without the knowledge and consent of the board of directors of the Waco bank.[25]

In addition to the defenses that went to the sufficiency of the indictment, the defendant set forth several constitutional defenses which also did not sway the court in upholding the indictment. The defendants argued that the double jeopardy clause prohibited the government's appeal. Their basis for this contention was *United States v. Lewis*,[26] where the district court's dismissal of an indictment after an evidentiary hearing *but before trial* was subsequently upheld by the court of appeals. The Supreme Court, however, has vacated the decision in *Lewis*[27] and remanded the case for consideration in light of the Court's decision in *Serfass v. United States*,[28] which reiterated the principle that jeopardy does not attach until the defendant is "put to trial before the trier of facts, whether the trier be a jury or a judge."[29] In addition to the double jeopardy defense, the defendants contended that the ex post facto clause barred the prosecution in this case. They argued that their activities prior to the promulgation of Banking Circular No. 31 were not considered illegal, and that to hold them as such, at this point, would be unconstitutional. The flaw in that argument, however, was that Banking Circular No. 31 was not the point at which the defendant's prior activities became illegal. 18 U.S.C.A. §656 and its penalty long predated the defendant's prosecution, and it is upon this statute that the government based its case. The defendants next contended that the prosecution should be prohibited because it was an ex post facto application of criminal sanctions and an unlawful retroactive application of government policy. They contended that there had been no prosecutions of the present nature or specific warning that the conduct under scrutiny in this case was deemed to be criminal prior to the issuance of Banking Circular No. 31. This defense was based on the rationale set forth in *Raley v. Ohio*,[30] which prohibited prosecution of a citizen for exercising a privilege that the state had indicated was available to him, and also, prohibited prosecution if the government's conduct had "actively misled" the person in order to prosecute. In addition to *Raley*, the defendants relied on *United States v. Laub*,[31] which held that "citizens may not be punished for actions undertaken in good faith reliance upon authoritative assurance that punishment will not attach."[32] Thus, in order for the defendants to invoke the *Raley-Laub* rationale, they had to prove that there had been a widespread

denied, 394 U.S. 933, 89 S.Ct. 1205, 22 L.Ed.2d 463 (1969).

25. 517 F.2d at 268, *citing* United States v. Klock, 210 F.2d 217, 220 (2nd Cir. 1954).
26. 492 F.2d 126 (5th Cir. 1974).
27. 421 U.S. 943, 95 S.Ct. 1671, 44 L.Ed.2d 97 (1975).
28. 420 U.S. 377, 95 S.Ct. 1055, 43 L.Ed.2d 265 (1975).
29. 517 F.2d at 266, *quoting* 420 U.S. at 391, 95 S.Ct. at 1062, 43 L.Ed.2d 275 (1975).
30. 360 U.S. 423, 79 S.Ct. 1257, 3 L.Ed.2d 1344 (1959).
31. 385 U.S. 475, 87 S.Ct. 574, 17 L.Ed.2d 526 (1967).
32. 385 U.S. at 487, 87 S Ct. at 581, 17 L.Ed.2d 534 (1967).

practice of entering into preferential loans of the kind involved in this case, along with an absence of prior prosecutions or some authoritative assurance on behalf of the government that punishment would not attach. In a trial on the merits, the defendants may be able to prove that there had been a widespread practice of entering into loans of the kind involved in this case, however, they will have difficulty proving an absence of prior prosecutions as well as silence on behalf of the government. In this regard, one last fact of the case remains. It was undisputed by the parties that the loans in this case were renewed four times *following* the issuance of Banking Circular No. 31. The defendants may well have been misled prior to the issuance of the circular, but they certainly could not have been misled afterwards. In fact, inconsistencies in the defendant's pleadings admitted to this fact. Defendants next contended that the indictment should have been dismissed because they had been unfairly singled out for prosecution. They claimed a denial of equal protection of the law, allegedly due to the fact that the loan practice was widespread and others who engaged in similar activities were not being punished. The *Mann* court indicated that the judiciary should not interfere with the free exercise of discretion of the attorneys of the United States, since it is the perogative of the executive, and not the judiciary, to initiate criminal proceedings.[33] The final defense relied upon was that the prosecution contravened the public policy of the United States by attempting to regulate private business through criminal prosecutions. In answer to this argument the court stated that "public policy favors the unencumbered enforcement of criminal laws . . . ."[34]

The court's reasoning and ruling in *Mann* is clear. The maintenance of a compensating balance in return for a preferential interest rate loan is now an indictable offense under 18 U.S.C.A. §656. Although the court did not reach a decision on the merits, a quote from *Brookshire* may have already forecasted the outcome:

> If, as defendant says, this practice is the usual way in which bankers do business, those who engage in it must suffer the penalty which the law constitutionally provides.[35]

MICHAEL A. MCKENZIE

33. 517 F.2d at 271, *citing* United States v. Cox, 342 F.2d 167 (5th Cir.) (en banc), *cert. denied*, 381 U.S. 935, 85 S.Ct. 1767, 14 L.Ed.2d 700 (1965).

34. 517 F.2d at 271, *quoting* United States v. St. Regis Paper Co., 355 F.2d 688, 693 (2nd Cir. 1966).

35. 514 F.2d at 790.