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Criminal Prosecution of Bank Personnel Under the Misapplication Statute: The Proper Mens Rea Standard for Establishing Intent

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RECENT DEVELOPMENTS

Criminal Prosecution of Bank Personnel Under the Misapplication Statute: The Proper *Mens Rea* Standard for Establishing Intent

I. INTRODUCTION

The Misapplication Statute[1] imposes criminal penalties on any bank officer, director, agent, or employee who willfully misapplies

1. The Misapplication Statute provides:
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, or a receiver of a national bank, or any agent or employee of the receiver, or a Federal Reserve Agent, or an agent or employee of a Federal Reserve Agent or of the Board of Governors of the Federal Reserve System, embezzles, abstracts, purloins or willfully misapplies any of the moneys, funds or credits of such bank or any moneys, funds assets or securities intrusted to the custody or care of such bank, or to the custody or care of any such agent, officer, director, employee or receiver, shall be fined not more

bank assets exceeding one hundred dollars.[2] Section 656 is one of the most useful tools for prosecuting insider misconduct in the banking industry.[3] The federal government's recent willingness to prosecute bank insider misconduct[4] has resulted in increased reliance on the Misapplication Statute in the federal courts.

To sustain a section 656 conviction, the government must prove four elements: (1) that the accused was an officer, director, agent, or employee of a bank; (2) that the bank was a national or federally insured bank; (3) that the accused willfully misapplied the bank funds; and (4) that the accused acted with the intent to injure or defraud the bank.[5] The prosecutor generally is able to establish the first two elements of the misapplication crime through the use of uncontested evidence. By examining relevant bank documents[6] and the defendant's actions,[7] the prosecutor can

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than $5,000 or imprisoned not more than five years, or both; but if the amount embezzled, abstracted, purloined or misapplied does not exceed $100, he shall be fined not more than $1,000 or imprisoned not more than one year, or both.

18 U.S.C. § 656 (1982).

2. Section 656 does not apply to state chartered banks that are not members of the Federal Reserve or the Federal Deposit Insurance Corporation (FDIC). *See* 12 U.S.C. § 221 (1982).

3. Other statutes that the government frequently relies on to prosecute bank insiders include: 18 U.S.C. §§ 215 (receipt of commissions or gifts for procuring loans), 371 (conspiracy to commit offense or to defraud the government), 655 (theft by bank examiner), 1005 (false statements by bank officer), 1014 (false statements on loan and credit applications) (1982).

4. *See* O'Malley, *The Federal Criminal Liability of Bank Personnel Under the Misapplication Statute*, 99 BANKING L.J. 100, 102 (1982).

5. *See* United States v. Broome, 628 F.2d 403, 405 (5th Cir. 1980); United States v. Duncan, 598 F.2d 839, 858 (4th Cir.), *cert. denied*, 444 U.S. 871 (1979); United States v. Schoenhut, 576 F.2d 1010, 1024 (3d Cir.), *cert. denied*, 439 U.S. 964 (1978).

6. *See* Cox, *Sinister Hybrid—Civil Constraint and Criminal Liability*, 96 BANKING L.J. 834, 837 (1979).

7. Judge Friendly, in United States v. Docherty, 468 F.2d 989 (2d Cir. 1972), provided several examples of illegal bank employee activity.

> Willful misapplication has been found, for example, when a bank employee knowingly engaged in a check 'kiting' scheme for the benefit of depositors, when a bank employee paid money out to a customer on a check he knew was backed by insufficient funds and then concealed the overdraft, when a bank officer loaned money without security knowing that the borrower could not repay, when a depositor repeatedly overdrew his account, knowing that the branch manager was consistently ignoring this, when a bank officer caused his bank to borrow from another and pocketed the proceeds, leaving his own bank only with a personal note of an employee of the lending bank which he had no reason to think would be paid, and, as we have recently held, when a bank officer pocketed the proceeds of loans knowingly issued on the strength of fraudulent loan applications.

Id. at 994 (citations omitted).

prove the third element of the crime.[8] To establish the fourth element, which constitutes the *mens rea* component of the crime, the prosecutor must deduce the defendant's motives and intentions.[9] Because of the enormous difficulty in producing evidence to prove the defendant's actual intentions, the hardest task in a section 656 prosecution is demonstrating beyond a reasonable doubt that the defendant acted with the intent to injure or defraud the bank.[10]

Courts have failed to resolve the problem of determining the proper standard of proof that is necessary to establish whether the defendant intended to injure or defraud the bank in a section 656 case. In recent years, the banking industry has become the subject of much scrutiny.[11] As a result of the recent instability of the financial industry and the alarming increase in the number of bank failures,[12] federal courts have had ample opportunity to reexamine

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8. The prosecutor may introduce objective evidence such as bank ledgers and bank officers' appointment books to show that something is awry in the handling of bank funds and that the suspected officer was physically capable of committing the willful misapplication.

9. *See generally* R. PERKINS, PERKINS ON CRIMINAL LAW 739-47 (2d ed. 1969) (discussing *mens rea*).

10. The National Bank Act of 1864 contained the first formulation of the Misapplication Statute. Section 5209 of the Act provided:

> And be it further enacted that every president, director, cashier, teller, clerk, or agent of any association, who shall embezzle, abstract, or willfully misapply any of the moneys, funds, or credits of the association . . . shall be deemed guilty of a misdemeanor, and upon conviction thereof shall be punished by imprisonment not less than five nor more than ten years.

National Bank Act of 1864, ch. 106, § 55, 13 Stat. 116. The substance of the Act is retained in § 656. *See supra* note 1 (text of 18 U.S.C. § 656). Congress amended the 1864 Act specifically to include the requirement of a showing of "intent . . . to injure or defraud" the association. Rev. Stat. U.S. § 5209, *as amended* Sept. 26, 1918, ch. 177, § 7, 40 Stat. 972.

Although the 1948 revision of Title 18 omitted the words "with intent to injure or defraud," *see* Morse, *Bank Insiders and the Willful Misapplication Statute: Toward More Effective Protection from Self-Dealing*, 92 BANKING L.J. 715, 725-26 (1975), courts, nevertheless, continue to require proof of *mens rea* as an element of a § 656 crime. *See, e.g.*, Seals v. United States, 221 F.2d 243, 245 (8th Cir. 1955); United States v. Logsdon, 132 F. Supp. 3, 5 (W.D. Ky. 1955), *aff'd*, 253 F.2d 12 (6th Cir. 1958). Congress eliminated the intent wording in an attempt to clarify the original version that critics had attacked as verbose, redundant, and complicated. *Id.*; *see also* Historical and Revision Notes, 18 U.S.C. § 656 (1982). Today, virtually all courts require the prosecution to demonstrate intent to injure or defraud as an element of a § 656 case. *See, e.g.*, United States v. Hansen, 701 F.2d 1215, 1218 (9th Cir. 1983); United States v. Luke, 701 F.2d 1104, 1108 (4th Cir. 1983); United States v. Adamson, 700 F.2d 953, 956 (5th Cir.), *cert. denied*, 104 S. Ct. 116 (1983); Hernandez v. United States, 608 F.2d 1361, 1364 (10th Cir. 1979). *But see* United States v. Twiford, 600 F.2d 1339, 1343 (10th Cir. 1979); United States v. Riebold, 557 F.2d 697, 701 (10th Cir.), *cert. denied*, 434 U.S. 860 (1977).

11. Scherschel & Black, *Bankers: Everybody's Favorite Target*, U.S. NEWS & WORLD REP., Apr. 11, 1983, at 27.

12. Over 100 banks have failed in the last 20 years. Nine of the 10 largest U.S. bank

the question of insider misconduct.[13] The United States circuit courts, however, continue to disagree over whether a finding of "recklessness"[14] satisfies the criminal intent requirement of section 656.[15] Despite attempts by circuit judges and legal scholars to design a uniform approach to section 656 violations, courts are split in their interpretations of the appropriate *mens rea* standard.

This Recent Development advocates legislative adoption of a new Misapplication Statute as a long range solution to the courts' continued debate over the appropriate *mens rea* standard and judicial adoption of a uniform approach as a short run alternative. Part II of this Recent Development traces the various *mens rea* standards that courts have applied under the Misapplication Statute. Part III discusses the current confusion over the appropriate section 656 *mens rea* standard by looking at three recent circuit court decisions.[16] Part IV advocates the adoption of a new Misapplication Statute similar to the approach that the National Commission on Reform of Criminal Laws suggests in its proposed revisions to Title 18. This approach delineates three categories of offenses, each corresponding to a different level of culpability and punishment. Part IV also suggests that until Congress drafts a new Misapplication Statute, the courts should establish a uniform standard for section 656 *mens rea* that restricts prosecution only to defendants who possess the traditional *mens rea* of knowledge.

II. LEGAL BACKGROUND

Congress enacted the Misapplication Statute to enable the prosecution of a variety of offenses.[17] Prosecutors have used the

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failures have occurred in the last 12 years. J. SINKEY, FINANCIAL CRISES: INSTITUTIONS AND MARKETS IN A FRAGILE ECONOMY 24-41 (E. Altman & W. Sametz ed. 1977).

13. *See* O'Malley, *supra* note 4, at 100-02.

14. The recklessness standard holds that the "[r]eckless disregard of the interests of the bank is equivalent to intent to injure or defraud." United States v. Hansen, 701 F.2d 1215, 1218 (7th Cir. 1983); United States v. Schoenhut, 576 F.2d 1010, 1024 (3d Cir.), *cert. denied*, 439 U.S. 964 (1978).

15. *See, e.g.*, United States v. Adamson, 700 F.2d 953 (5th Cir.) (survey of the applicable standards in different circuits), *cert. denied*, 104 S. Ct. 116 (1983); Morse, *supra* note 10, at 727-30.

16. Within the span of eight days in March 1983, three circuit courts rendered decisions concerning the appropriate *mens rea* standard under the Misapplication Statute. *See* United States v. Hansen, 701 F.2d 1215 (7th Cir. 1983); United States v. Luke, 701 F.2d 1104 (4th Cir. 1983); United States v. Adamson, 700 F.2d 953 (5th Cir.), *cert. denied*, 104 S. Ct. 116 (1983).

17. One commentator suggested that Congress specifically provided the broad language of "willful misapplication" to encompass a wide range of insider misconduct. *See* Morse, *supra* note 10, at 739.

statute in a number of insider misconduct situations ranging from kickback schemes to account overdrafts.[18] To maintain the flexibility that is necessary to sustain section 656 convictions in such disparate fact situations, courts have had to adopt different *mens rea* standards to satisfy the requisite section 656 intent to injure or defraud. Courts' failure to articulate with consistency the precise *mens rea* standard that they apply has prevented the establishment of a single *mens rea* test.

A. The Objective Standard of Intent

In recent years, judicial interpretations of section 656 *mens rea* suggest that criminal misapplication has evolved into "virtually a strict liability offense."[19] By adopting the position that juries may presume the intent to injure or defraud from the defendant's admission that he performed a certain act, even though he was unaware that the act was detrimental to the bank, the federal courts have created an objective standard of intent.[20] Rather than consider the defendant's subjective intent, courts infer intent from his objective overt actions. Thus, a prosecutor using this approach may prove the *mens rea* element of a misapplication offense merely by showing that the accused bank officer performed certain acts as part of his job.[21]

Although courts have resisted labelling the application of the *mens rea* requirement as an objective standard, a review of court decisions addressing this issue indicates judicial acceptance of the broad objective test for section 656 intent. For example, in *United States v. Southers*[22] the court upheld a section 656 criminal conviction of a bank officer whose credit decisions did not accord with established banking custom.[23] In reaching this decision, the court

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18. *See supra* note 7.

19. Cox, *supra* note 6, at 837.

20. *See id.* at 838. For example, when a bank officer makes a loan to a third party that the officer believes is creditworthy, the officer knows that he has completed the physical act of making the loan. The officer, however, may have no actual knowledge that the third party is using the officer illegally to procure bank funds. Courts, nevertheless, may impose § 656 liability on the bank officer for making "risky loans" to a noncreditworthy party.

21. *See* United States v. Kernoodle, 367 F. Supp. 844 (M.D.N.C. 1973), *aff'd*, 506 F.2d 1398 (4th Cir. 1974). For example, in a prosecution of bank officers for approving financially unsound loans, the government merely had to demonstrate that the defendant performed "several overt acts relating to issuing or cashing checks, and making loans." *Id.* at 850.

22. 583 F.2d 1302 (5th Cir. 1978).

23. As an authorized officer, the defendant had issued and signed six cashier's checks for a total of $15,900. Two of the checks were payable to the defendant, three were payable to his creditors, and one was payable to a third party who had exhausted his credit limit at

refused to consider that all the loans which the officer made were repaid, that the officer continuously acted in what he perceived to be the bank's best interests, and that the bank actually may have profited from the officer's actions.[24] The court adopted an objective standard for finding section 656 intent and looked solely at the officer's overt conduct in holding that he acted with the intent to injure or defraud the bank.[25] Consequently, under the *Southers* rationale, once the prosecution establishes the first three elements of the misapplication offense,[26] the judge may instruct the jury to presume the intent to injure or defraud from the fact that the officer knowingly committed the acts in question.[27]

Similarly, in *United States v. Reynolds*[28] the court permitted the jury to infer that the defendant had intended to defraud or injure the bank when he deviated from the bank's normal check clearing process. The court found a presumption of the requisite intent from an objective view of the defendant's actions, even though the defendant contended that he had followed the bank president's orders and believed that he was acting in the bank's best interest.[29] *Southers* and *Reynolds* evidence the recent trend in misapplication cases towards relaxing the standard that is necessary to obtain criminal indictments and convictions.[30] Judicial application of the objective standard of intent in banking, a business in which violations are easy to document because of bank records,[31] has resulted in an unusually high conviction rate for violations of the Misapplication Statute.[32]

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the bank. The parties receiving the checks gave neither payment nor security, "contrary to banking custom." *Id.* at 1304.

24. *See id.* at 1302; *see also* United States v. Tidwell, 559 F.2d 262, 266 (5th Cir. 1977), *cert. denied*, 435 U.S. 942 (1978); United States v. Acree, 466 F.2d 1114, 1118 (10th Cir. 1972), *cert. denied*, 410 U.S. 913 (1973); United States v. Kernoodle, 367 F. Supp. 844 (M.D.N.C. 1973), *aff'd*, 506 F.2d 1398 (4th Cir. 1974).

25. *Southers*, 583 F.2d at 1305.

26. *See supra* text accompanying note 5.

27. *See Southers*, 583 F.2d at 1306-07; Cox, *supra* note 6, at 837-38.

28. 573 F.2d 242 (5th Cir. 1978).

29. *Id.* at 244-45.

30. *See* Morse, *supra* note 10, at 729-30 & n.49. The author explains, "This relaxation derives not only from the general relaxing of the old technical forms of criminal pleading . . . but is also seen as an increased willingness of courts to accept an allegation of willful misapplication with fewer specifics." *Id.* (citations omitted).

31. Cox, *supra* note 6, at 840.

32. Assistant United States Attorney Kevin O'Malley has compiled statistics that evidence an amazing 97.5% conviction rate for accused § 656 violators that federal grand juries indicted in fiscal year 1980. O'Malley, *supra* note 4, at 101.

B. *Knowingly Versus Recklessly*

Courts have rendered inconsistent decisions concerning whether the defendant must have acted knowingly or in reckless disregard of the bank's interests to satisfy the section 656 *mens rea* requirement. Some circuit courts have upheld jury instructions equating the intent to injure with mere reckless disregard of the bank's interest.[33] Using this formulation, the court determines whether the bank officer's actions were reckless rather than whether the bank officer possessed actual criminal intent. The court's hindsight analysis of the defendant's conduct controls the finding of guilt or innocence under the recklessness standard.[34]

Two distinct problems arise when a court allows the recklessness standard to satisfy the criminal intent requirement of section 656. First, assuming that knowledge is the proper *mens rea* for a felony conviction under section 656,[35] the court's practice of holding that recklessness is equivalent to knowledge violates constitutional due process. The due process clause[36] requires a prosecutor to prove beyond a reasonable doubt every element of the criminal charge.[37] Criminal intent is an established element of misapplication of funds under section 656.[38] The Supreme Court consistently has held that "[a] presumption which would permit but not require the jury to assume intent from an isolated fact would prejudice a conclusion which the jury should reach of its own voli-

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33. *See, e.g.*, United States v. Hansen, 701 F.2d 1215, 1218 (7th Cir. 1983); United States v. Thomas, 610 F.2d 1166, 1174 (3d Cir. 1979); United States v. Larson, 581 F.2d 664, 667-68 (7th Cir. 1978); United States v. Cooper, 577 F.2d 1079, 1082 (6th Cir.), *cert. denied*, 439 U.S. 868 (1978); Giragosian v. United States, 349 F.2d 166, 169 (1st Cir. 1965); Logsdon v. United States, 253 F.2d 12, 15 (6th Cir. 1958).

34. For example, a court may find a bank president guilty of a § 656 felony if, in approving the temporary transfer of bank funds to cover defaulting loans, he acted recklessly, even though he clearly had no intent to injure or defraud the bank. *See, e.g.*, United States v. Welliver, 601 F.2d 203 (5th Cir. 1979), *rev'd*, 700 F.2d 953 (5th Cir.), *cert. denied*, 104 S. Ct. 116 (1983).

35. *See* United States v. Adamson, 700 F.2d 953, 956-57 (5th Cir.), *cert. denied*, 104 S. Ct. 116 (1983) (a general review of the legislative history of § 656 and Supreme Court and circuit court opinions on the subject establishing that knowledge is the appropriate *mens rea* standard for § 656).

36. The due process clause of the United States Constitution provides "nor shall any State deprive any person of life, liberty, or property, without due process of law . . . ." U.S. CONST. amend. XIV, § 1.

37. *In re* Winship, 397 U.S. 358 (1970). According to the Supreme Court: "Lest their remain any doubt about the constitutional stature of the reasonable-doubt standard, we explicitly hold that the Due Process Clause protects the accused against conviction except upon proof beyond a reasonable doubt of every fact necessary to constitute the crime with which he is charged." *Id.* at 364; *see also* Patterson v. New York, 432 U.S. 197, 210 (1977).

38. *See supra* text accompanying note 5.

tion."[39] Consequently, any court that allows the presumption of section 656 *mens rea* from the defendant's reckless conduct is removing both a critical decision from the jury and the necessary burden of proof from the prosecution.[40] Thus, by equating the lesser *mens rea* standard of recklessness with the higher *mens rea* standard of knowledge, courts may violate the due process clause.[41]

Second, the recklessness approach to section 656 presents serious difficulties for bank officers. Under the recklessness standard, bank officers must analyze each activity that they plan to undertake to try to anticipate any risk of loss to the bank. If a transaction potentially may result in a loss to the bank, which is always possible in daily banking operations,[42] the bank officer should refuse to complete the transaction or prepare for a criminal sentence if a court finds that he acted recklessly.[43] Courts that have adopted the recklessness standard for willful misapplication must decide to what extent they will prosecute bankers for engaging in risk-taking activities as a normal function of their occupation.

Several circuit courts have refused to accept any *mens rea* standard less than knowledge for purposes of satisfying section 656

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39. Morissette v. United States, 342 U.S. 246, 275 (1952) (defendant, charged with willful and knowing theft of government property, wrongfully convicted when the trial judge allowed a presumption of intent from the defendant's act); *see also* Sandstrom v. Montana, 442 U.S. 510, 513 (1979) (defendant, charged with deliberate homicide, prejudiced when the trial judge instructed the jury that "[t]he law presumes that a person intends the ordinary consequences of his voluntary acts"); United States v. United States Gypsum, 438 U.S. 422, 438 (1978) (defendants charged with criminal violations of the Sherman Act successfully challenged a jury instruction that the law presumes a person intends the necessary consequences of his acts).

40. *See, e.g.*, Sandstrom v. Montana, 442 U.S. 510 (1979); Patterson v. New York, 432 U.S. 199 (1977); Mullaney v. Wilbur, 421 U.S. 684 (1975).

41. *Sandstrom*, 442 U.S. at 520-23; *Adamson*, 700 F.2d at 956.

42. One commentator noted, "With regard to credit extension, it is arguable that every decision to make or extend a loan creates *some* risk of loss or injury to the bank." Morse, *supra* note 10, at 729 (emphasis in original).

43. Generally accepted banking practices justify the extension of loans that are risky and even loans that eventually will turn sour. M. MAYER, THE BANKERS 296 (1974).

In early misapplication cases, courts distinguished between acts of "maladministration" and acts of "misapplication." Justice Woods, writing for the Supreme Court in United States v. Britton, 107 U.S. 655 (1882), outlined the heightened requirements associated with prosecution under the Misapplication Statute. *Id.* at 668. Justice Woods warned that if the court permitted prosecutions when the defendant did not possess the specific intent to defraud the bank through conversion of bank funds, "every official act of any officer, clerk, or agent of a banking association, by which its funds are applied in a way not authorized by law, would be punishable under sect. 5209 [now 18 U.S.C. § 656]." *Id.* at 667. Justice Woods' strict line of demarcation between acts of maladministration and acts of misapplication no longer exists. Consequently, judges and prosecutors often overlap the concepts of maladministration and misapplication when dealing with modern § 656 violations.

criminal intent.[44] The prosecution can meet the knowledge standard by proving that the bank officer knowingly and voluntarily injured or defrauded the bank.[45] The *mens rea* distinction between knowledge and recklessness becomes most apparent in credit allocation decisions and other lending situations. For example, the United States Court of Appeals for the First Circuit reversed a bank officer's conviction for lending money to a financially capable borrower who planned to distribute the funds to a third party[46] and held that criminal responsibility under section 656 requires knowledge that the named borrowers were financially incapable of affording the loans.[47] Even though the bank officer's act of lending might have been reckless, the court held that section 656 calls for the higher *mens rea* standard of knowledge.[48]

Similarly, the Eighth Circuit expressly rejected the recklessness standard and held that conduct that "might be viewed as naive and perhaps reckless" does not constitute sufficient knowledge to support a criminal conviction.[49] Recently, the Eleventh Circuit upheld a jury conviction of misapplication when the court determined that the accused bank official knowingly and voluntarily had arranged for and accepted loans in amounts large enough to pose a serious threat of harm to the financial stability of the lending institution.[50] The views of the First, Eighth, and Eleventh Circuits,[51] in comparison with the circuit courts that embrace a reck-

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44. *See, e.g.*, United States v. Gregory, 730 F.2d 692 (11th Cir. 1984); United States v. Adamson, 700 F.2d 953 (5th Cir. 1983); United States v. Gens, 493 F.2d 216 (1st Cir. 1974); Snyder v. United States, 448 F.2d 716 (8th Cir. 1971).

45. *See Adamson*, 700 F.2d at 965.

46. United States v. Gens, 493 F.2d 216 (1st Cir. 1974). In *Gens* the borrower planned to turn over the proceeds of the loan to a third party who otherwise would not have been able to procure a loan. Because several bank officers knew of this arrangement, the court could have deemed the act of lending a reckless disregard of the bank's interests. *Id.* at 222. The First Circuit, however, held that the borrower's financial capability rebutted any evidence sufficient to convict the officers under the higher *mens rea* standard of knowledge. *Id.*

47. *Id.*

48. *Id.*

49. *See* Snyder v. United States, 448 F.2d 716, 719 (8th Cir. 1971).

50. The Eleventh Circuit, in United States v. Gregory, 730 F.2d 692 (11th Cir. 1984), upheld the conviction of the owners of a controlling interest in an Alabama bank who knowingly, and in contravention of both bank and FDIC policy, arranged for the issuance of several exceedingly high loans to themselves and corporations they owned. The court gave several reasons for its decision: (1) the accused had access to daily reports on the status of the loans; (2) the accused knew that local banking policy and FDIC policy prohibited the loans; and (3) the accused voluntarily approved and accepted loans that were above the allowable limits. *Id.* at 702.

51. The Fifth Circuit also clearly rejected the recklessness standard. *See* United States v. Adamson, 700 F.2d 953 (5th Cir. 1983); *infra* notes 88-95 and accompanying text (discuss-

lessness *mens rea* standard,[52] demonstrate conflicting interpretations of the intent standard that section 656 requires.

III. Recent Decisions

Within a two week period during March 1983, three circuit courts rendered decisions concerning the appropriate *mens rea* standard for the Misapplication Statute. In *United States v. Hansen*[53] the Seventh Circuit affirmed a section 656 conviction on the grounds that "reckless disregard of the interests of the bank is equivalent to intent to injure."[54] The Fourth Circuit, in *United States v. Luke*,[55] determined that a bank employee's general knowledge of a de facto loan to a third party rather than to the named debtor satisfied the *mens rea* requirement of section 656.[56] Finally, in *United States v. Adamson*,[57] the Fifth Circuit adopted the purportedly uniform rule that the appropriate *mens rea* standard for a section 656 conviction is knowledge and overruled the recklessness standard that the Fifth Circuit previously had employed in section 656 suits.[58]

A. United States v. Hansen

In *United States v. Hansen*[59] the defendant, acting in his capacity as a bank lending officer, exceeded statutory lending limits, arranged fraudulent loans without the consent of the named borrowers, and retained a portion of the fraudulent loans for himself pursuant to an unlawful agreement.[60] In affirming the conviction, the Seventh Circuit found sufficient evidence to support the jury's conclusion that the defendant had acted knowingly and that "the

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ing *Adamson*).

52. The Third, Sixth, and Seventh Circuits have adopted the recklessness standard. *See, e.g.*, United States v. Hansen, 701 F.2d 1215 (7th Cir. 1983); United States v. Thomas, 610 F.2d 1166 (3d Cir. 1979); United States v. Cooper, 577 F.2d 1079 (6th Cir.), *cert. denied*, 439 U.S. 868 (1978).

53. 701 F.2d 1215 (7th Cir. 1983); *see infra* notes 59-65 and accompanying text.

54. *Hansen*, 701 F.2d at 1218.

55. 701 F.2d 1104 (4th Cir. 1983); *see infra* notes 66-77 and accompanying text.

56. *Luke*, 701 F.2d at 1107.

57. 700 F.2d 953 (5th Cir.), *cert. denied*, 104 S. Ct. 116 (1983); *see infra* notes 78-95 and accompanying text.

58. *Adamson*, 700 F.2d at 968; *see, e.g.*, United States v. Welliver, 601 F.2d 203 (5th Cir. 1979); United States v. Reynolds, 573 F.2d 242 (5th Cir. 1978); United States v. Wilson, 500 F.2d 715 (5th Cir. 1974), *cert. denied sub nom.* White v. United States, 420 U.S. 977 (1975).

59. 701 F.2d 1215 (7th Cir. 1983).

60. *Id.* at 1217.

natural result of his conduct would be to injure and defraud the bank."[61] The court, however, did not base its decision solely upon the knowing conduct of the defendant. Without explanation, the court introduced the recklessness standard and equated it with the requisite intent to injure or defraud.[62] Typical of many court opinions that have tangled with the section 656 *mens rea* problem, the Seventh Circuit used the concepts of knowledge and recklessness interchangeably and failed to enunciate a clear *mens rea* standard.[63]

The Seventh Circuit did not need to resort to a recklessness standard to affirm the defendant's conviction. The court had concluded that the jury instructions adequately explained the knowledge standard[64] and that sufficient evidence existed of the defendant's purposeful arrangement to convert loans to his personal use through kickbacks.[65] The facts clearly supported a proper finding of section 656 willful misapplication without introduction of the recklessness standard. The Seventh Circuit, however, in affirming the defendant's conviction, inexplicably included the lesser *mens rea* standard of recklessness, rather than the more stringent requirement of knowledge, as the basis for the decision.

B. United States v. Luke

In *United States v. Luke*[66] the defendants were neither bank officers nor bank employees. Because of their alleged affiliation with a bank lending official, however, the prosecutor brought charges against the defendants under section 656 through the aidor and abettor provision of Title 18.[67] The defendants, acting under a

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61. *Id.* at 1218-19.

62. The Seventh Circuit stated that the "[r]equisite intent 'exists whenever the defendant acts knowingly and the result of his conduct would be to injure or defraud the bank, *regardless of his motive* . . . . Reckless disregard of the interests of the bank is equivalent to intent to injure or defraud.' " *Id.* at 1219 (emphasis in original) (citing United States v. Schoenhut, 576 F.2d 1010, 1024 (3d Cir.), *cert. denied*, 439 U.S. 964 (1978)).

63. *See* United States v. Larson, 581 F.2d 664 (7th Cir. 1978) (pre-*Hansen* decision in which the court interchangeably used knowledge and recklessness standards without adequate distinction).

64. The trial judge bad instructed the jury: "Intent to defraud a bank exists if tbe officer or employee acts knowingly and if the natural result of his conduct would be to injure and defraud the bank, even though that may not have been his motive." *Hansen*, 701 F.2d at 1218.

65. *Id.* at 1219.

66. 701 F.2d 1104 (4th Cir. 1983).

67. The "aidor and abettor" provision of Title 18 states, "Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal." 18 U.S.C. § 2(a) (1982).

plan that the bank officer devised, procured bank funds and gave them to a third party debtor, who used the money to repay his defaulted loans.[68] The Fourth Circuit affirmed the convictions of the two defendants without fully considering the *mens rea* element of the Misapplication Statute.[69]

The *Luke* court characterized the defendant's loan scheme as one of the three willful misapplication situations that the First Circuit outlined in *United States v. Gens*.[70] The Fourth Circuit determined that the *Luke* scenario fit neatly into the *Gens* third category, "in which bank officials assured the named debtor, regardless of his financial capabilities, that they would look for repayment only to the third party who actually received the loan proceeds."[71] The *Gens* categories, however, illustrate situations concerning the knowing conduct of bank officers, while *Luke* addressed the conduct of commercial loan recipients who may or may not have known that the bank was not holding them ultimately liable for the loans in question.

The defendants in *Luke* characterized the loan as two legitimate transactions: a bona fide loan by the bank to the defendants' company followed by a gift from the company to a third party debtor.[72] Admittedly, the *Luke* court could have concluded that the bank officer had known to whom he would look for repayment of the defendants' loan, but no evidence existed to indicate that the loan recipients had known whom the bank ultimately would hold financially responsible. Thus, the Fourth Circuit incorrectly analogized the situation in *Luke*, which concerned the knowledge

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68. *Luke*, 701 F.2d at 1105-06.

69. *Id.* at 1108.

70. 493 F.2d 216 (1st Cir. 1974). The *Gens* court explained:

> The cases of this type in which willful misapplication has been found fall into three general categories. First, those in which bank officials knew the named debtor was either fictitious or wholly unaware that his name was being used . . . . Second, cases in which bank officials knew the named debtor was financially incapable of repaying the loan whose proceeds he passed on to the third party . . . . Third, cases in which bank officials assured the named debtor, regardless of his financial capabilities, that they would look for repayment only to the third party who actually received the loan proceeds: in other words where the debtor allowed only his name to be used, enabling the bank officials to grant a *de facto* loan to a third party to whom the bank was unwilling to grant a formal loan.

Id. at 221-22 (emphasis in original); *see also* United States v. Stokes, 471 F.2d 1318 (5th Cir. 1973) (fictitious debtor); United States v. Moraites, 456 F.2d 435 (3d Cir. 1972), *cert. denied*, 409 U.S. 891 (1972) (de facto loan); Mulloney v. United States, 79 F.2d 566 (1st Cir. 1935) (financially incapable debtor), *cert. denied*, 296 U.S. 658 (1936).

71. *Luke*, 701 F.2d at 1107 (quoting *Gens*, 493 F.2d at 221-22).

72. *Luke*, 701 F.2d at 1107.

of the named debtor, with the willful misapplication scenario of *Gens*, which addressed the knowledge of the bank employee.

The *Luke* court only superficially addressed the criminal intent component of section 656. In fact, the cases that the court cited to support a finding of intent concerned the *mens rea* necessary under the statute to convict bank employees for knowing acts and discussed neither the distinction between knowing and reckless conduct nor the liability of nonemployee loan recipients.[73] In addressing the *mens rea* requirement, the Fourth Circuit was content to find a "sham" loan, as the *Gens* court defined the term,[74] and that the loan had "temporarily deprive[d] the bank of possession, control or use of its funds."[75] After establishing the existence of the loan and the defendants' affiliation with the bank officer, the court felt that the prosecution had established the crime of misapplication.[76] Thus, the Fourth Circuit not only treated section 656 as a strict liability offense,[77] but also extended the *Gens* analysis to nonbank personnel.

C. United States v. Adamson

In *United States v. Adamson*[78] the Fifth Circuit, sitting en banc, considered the legislative history of section 656, the views of the other circuit courts, and the constitutional issues surrounding the Misapplication Statute. The court reversed the former holding in *Adamson* and overruled the recklessness standard that the Fifth Circuit had employed in previous section 656 cases.[79] The defendant in *Adamson*, a bank lending officer, had authorized a substantial loan to a corporation that was under the control of two individuals.[80] These individuals were the actual beneficiaries of the loan, even though their financial status would have barred them from procuring a loan through normal procedures.[81] The defendant banker admitted that he did not expect the corporation to repay

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73. The court relied on United States v. King, 484 F.2d 924 (10th Cir. 1973), *cert. denied*, 416 U.S. 904 (1974), and United States v. Moraites, 456 F.2d 435 (3d Cir.), *cert. denied*, 409 U.S. 891 (1972). Both *King* and *Moraites* concerned situations of knowing conduct by bank officers or directors.

74. *Gens*, 493 F.2d at 221.

75. *Luke*, 701 F.2d at 1108.

76. *Id.*

77. *See supra* notes 19-21 and accompanying text.

78. 665 F.2d 649 (5th Cir. 1982), *rev'd on reh'g*, 700 F.2d 953 (5th Cir. 1983) (en banc).

79. *See, e.g.*, cases cited *supra* note 58.

80. *Adamson*, 700 F.2d at 955.

81. *Id.*

the loan, but believed that the individual beneficiaries were to repay the debt.[82] When the bank failed, the government prosecuted the bank officer and the two beneficiaries of the loan under section 656.[83]

On appeal to the Fifth Circuit the defendant challenged the trial judge's jury instruction equating recklessness with section 656 criminal intent.[84] The initial Fifth Circuit panel, after examining controlling precedent in the circuit,[85] affirmed the conviction.[86] Even though the court was uneasy with its holding, it nonetheless determined that section 656 "imposes only a *mens rea* standard of recklessness."[87]

Upon rehearing en banc, the Fifth Circuit held that knowledge was the appropriate *mens rea* standard for the Misapplication Statute.[88] The court, after examining section 656's predecessor statute, found that the knowledge standard of the predecessor statute carried over to section 656.[89] The Fifth Circuit further deter-

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82. *Id.*

83. *Adamson* raises the fear that if recklessness is sufficient to satisfy § 656 *mens rea*, then federal prosecutors randomly will prosecute bank officials under the Misapplication Statute. Especially following large bank failures, federal prosecutors may justify § 656 prosecutions of bank lending officers in an attempt to restore public faith in the banking industry by punishing the bank for making risky loans. Courts that tolerate these suits seriously will impair the banks' credit allocation function. *See supra* notes 42-43.

84. *Adamson*, 665 F.2d at 651. In particular, the defendant challenged the instruction: "I charge you that the element of criminal intent necessary for conviction for a willful misapplication of bank funds is not fulfilled by a mere showing of indiscretion or foolhardiness on the part of the bank officer. His conduct must amount to reckless disregard of the bank's interests . . . ." *Id.*

85. The court found precedent for the recklessness standard in a line of cases culminating with United States v. Welliver, 601 F.2d 203 (5th Cir. 1979). The defendant in *Welliver* had objected to a jury instruction that was almost identical to the charge in *Adamson*. The *Welliver* court upheld the instruction after determining that recklessness satisfied criminal intent for § 656 willful misapplication. *Welliver*, 601 F.2d at 210.

86. *Adamson*, 665 F.2d at 654-55.

87. *Id.* at 656. The court was uncomfortable with its decision:

> Several factors contribute to our difficulty with this holding: the inconsistent *mens rea* requirement of the related statute § 1005, the clear holding of cases construing § 656 as requiring purpose and the legislative history suggesting that § 656 was not intended to change the substance of the law, the uniform holdings of the other circuits construing § 656 to require either purpose or knowledge, and the strong dictum to the same effect in Fifth Circuit cases.

Id.

88. United States v. Adamson, 700 F.2d 953 (5th Cir.) (en banc), *cert. denied*, 104 S. Ct. 116 (1983).

89. *Id.* at 956-57. The predecessor statute to 18 U.S.C. § 656 (1982) was 12 U.S.C. § 592 (1946) (REV. STAT. § 5209 (2d ed. 1878)) (repealed 1948), which was substantially similar to the current statute, but included the language "with intent to injure or defraud." *See supra* note 10 (text of § 5209).

mined that the recklessness standard differed from the uniform standard of knowledge, which all the other circuits had adopted.[90] The court also recognized that allowing courts to presume the requisite *mens rea* standard from a finding of recklessness would violate constitutional due process.[91] Finally, the court compared section 656 with a companion statute, section 1005,[92] and concluded that the higher *mens rea* of knowledge, applicable in all section 1005 cases, also should prevail in section 656 cases.[93] Based on these findings, the Fifth Circuit overruled earlier precedent supporting the recklessness standard[94] and held that "[i]n order to convict a defendant for willfully misapplying funds with intent to injure or defraud a bank, the government must prove that the defendant *knowingly* participated in a deceptive or fraudulent transaction."[95]

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90. *Adamson*, 700 F.2d at 957-63. The Fifth Circuit's determination that other circuits uniformly had adopted knowledge as the appropriate *mens rea* standard in § 656 cases was misleading. Other circuits have held and continue to hold that reckless disregard of the interests of the bank is equivalent to intent to injure or defraud the bank. *See, e.g.*, United States v. Hansen, 701 F.2d 1215 (7th Cir. 1983); cases cited *supra* note 33. The Fifth Circuit did acknowledge that "several circuit court cases discussing the mental state required under section 656 contain loose references to recklessness," but distinguished these cases on the ground that the courts were referring to recklessness as a justified inference of intent. *Adamson*, 700 F.2d at 961-62 & n.14. Allowing recklessness as an inference of intent that is necessary to establish *mens rea* in presumed intent crimes, however, is tantamount to creating a presumption of knowledge that is based on recklessness. R. PERKINS, *supra* note 9, at 748.

91. *See supra* notes 35-41 and accompanying text.

92. Section 1005 provides in relevant part:

> Whoever, being an officer, director, agent or employee of any Federal Reserve bank, member bank, national bank or insured bank, without authority from the directors of such bank, issues or puts in circulation any notes of such bank; or
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> Whoever, without such authority, makes, draws, issues, puts forth, or assigns any certificate of deposit, draft, order, bill of exchange, acceptance, note, debenture, bond, or other obligation, or mortgage, judgment or decree; or
>
> Whoever makes any false entry in any book, report, or statement of such bank with intent to injure or defraud such bank, or any other company, body politic or corporate, or any individual person, or to deceive any officer of such bank, or the Comptroller of the Currency, or the Federal Deposit Insurance Corporation, or any agent or examiner appointed to examine the affairs of such bank, or the Board of Governors of the Federal Reserve System—
>
> Shall be fined not more than $5,000 or imprisoned not more than five years, or both.

18 U.S.C. § 1005 (1982).

93. *Adamson*, 700 F.2d at 964-65.

94. *See supra* note 85.

95. *Adamson*, 700 F.2d at 965 (emphasis in original).

The most recent Fifth Circuit case to discuss the § 656 *mens rea*, however, casts doubt on the effect of the *Adamson* ruling that the jury cannot infer knowledge from reckless conduct. In United States v. Cauble, 706 F.2d 1322 (5th Cir. 1983), *cert. denied*, 104 S. Ct.

IV. Two Possible Solutions

A flexible statutory scheme is necessary to discourage insider misconduct in the banking industry because of the numerous situations in which a violation may occur.[96] The Misapplication Statute has provided federal enforcement officials with a flexible tool for prosecuting a wide range of insider activity. The judicial system, however, has not achieved this flexibility without cost. By adopting the lesser *mens rea* standard of recklessness in section 656 felony convictions, courts have equated unintentional violations of section 656 with premeditated felonies such as embezzlement and fraud.[97] Courts must begin to recognize the varying degrees of culpability that exist under section 656 and employ a *mens rea* standard commensurate with the alleged violation.

Two possible solutions exist to alleviate the problem of applying the Misapplication Statute unfairly to alleged violators who possess a lesser *mens rea* than knowledge. First, as a long range solution, Congress should pass legislation that defines several kinds of *mens rea* under section 656. This legislation should provide the courts with the means to distinguish beween different degrees of culpability. Second, as a more immediate solution, the courts should adopt a uniform standard for evaluating the section 656 *mens rea*.

A. *The Long-Term Solution: A Tri-Level Culpability Standard*

The National Commission on Reform of Federal Criminal Laws has recommended a revision of Title 18 that would establish three levels of violations under regulatory statutes such as section 656.[98] The Commission's position has gained support among critics

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966 (1984), the Fifth Circuit surprisingly held that a jury *may* infer § 656 *mens rea* from reckless conduct. *Id.* at 1355. If the *Cauble* decision is the proper interpretation of the Fifth Circuit's holding in *Adamson, Cauble* seriously weakens the *Adamson* court's strong rejection of the recklessness standard.

As in *Luke*, the facts supporting the § 656 conviction in *Adamson* presented a questionable basis for finding a willful misapplication of bank funds with intent to injure or defraud the bank. The disparate results in *Luke* and *Adamson* evidence the confusion tbat still surrounds the Misapplication Statute and the different *mens rea* standards necessary to uphold a conviction in the various circuit courts.

96. *See supra* note 7.

97. *Compare* United States v. Hansen, 701 F.2d 1215 (7th Cir. 1983) (defendant arranged fraudulent loans in return for "kickbacks") *with* United States v. Luke, 701 F.2d 1104 (4th Cir. 1983) (defendants procured loans from the bank and used them to repay tbe defaulted loans of a third party debtor).

98. *See* United States National Comm'n on Reform of Federal Criminal Laws, Final Report of the National Comm'n on Reform of Federal Criminal Laws 74-75 (1971)

of section 656's current language.[99] The proposal distinguishes between traditional crimes that "are universally recognized outrages and threats to common security"[100] and regulatory crimes, which are practices that are *malum prohibitum*.[101] Because the Commission believes that not all violators of regulatory offenses are deserving of conviction and punishment unless they possess traditional criminal intent, the Commission delineated three categories of regulatory offenses, each requiring a different punishment.[102]

The first level of regulatory offenses under the proposed legislation would include nonculpable violations and would require compliance with a low *mens rea* standard.[103] In the context of the Misapplication Statute, nonculpable violators would include bank officers who unknowingly violate lending limits[104] or otherwise act recklessly. Federal prosecutors could use this lower level category to pursue bank officers and loan recipients whose reckless conduct has caused lending irregularities.[105] Because of the nonculpable nature of the violation, however, violators in this category would be subject to the lowest degree of punishment.[106]

Bank personnel who willfully violate the provisions of section 656 would be liable under the second regulatory category.[107] Willfullness under the proposed statute would apply to both conduct and the knowledge that the conduct is impermissible.[108] Federal prosecutors would have to prove that the defendant willfully misapplied funds and that he knew that his conduct was unlawful. This heightened knowledge requirement would insure that the jury

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(hereinafter cited as FINAL REPORT).

99. *See, e.g.*, Cox, *supra* note 6, at 844; Morse, *supra* note 10, at 753-55.

100. UNITED STATES NATIONAL COMM'N ON REFORM OF FEDERAL CRIMINAL LAWS, 1 WORKING PAPERS 403 (1970) (hereinafter cited as WORKING PAPERS). The Commission lists homicide, rape, and robbery as examples of traditional crimes. *Id.* at 403-04.

101. *Malum prohibitum* crimes are illegal only because a statute prohibits them. State v. Horton, 139 N.C. 588, 592, 51 S.E. 945, 946 (1905); W. LAFAVE & A. SCOTT, HANDBOOK ON CRIMINAL LAW § 6, at 29 (1972). Examples of *malum prohibitum* crimes include making false statements on official reports and generally violating business regulations. *See* WORKING PAPERS, *supra* note 100, at 410-18.

102. *See* FINAL REPORT, *supra* note 98, at 75-76 (comment to § 1006).

103. *See id.* at 74 (§ 1006(2)(a)).

104. *See, e.g.*, United States v. Christo, 614 F.2d 486 (5th Cir. 1980); 12 U.S.C. § 375(a) (1982).

105. For example, this standard might be appropriate for prosecuting third party offenders such as the defendants in *Luke*. *See supra* notes 66-69 and accompanying text.

106. The Commission suggests that these violators would be guilty of an infraction and receive nonpenal sanctions for their conduct. FINAL REPORT, *supra* note 98, at 74-76.

107. *Id.* at 74 (§ 1006(7)(b)).

108. *Id.* at 76.

considers the defendant's motive and knowledge when determining whether he possessed the requisite intent to injure or defraud the bank.[109] The statute would include a rebuttable presumption that the banker engaging in the regulated activity knew about the statute.[110] Most of the current violations of section 656 would fall into this category.[111]

The third category would apply to individuals who act willfully and in persistent disobedience of the regulating authority.[112] Prosecutors of a third level offense would have to prove not only that the individual acted willfully but also that the conduct occurred over a period of time.[113] Planned kickback schemes,[114] check kiting fraud,[115] bribery attempts,[116] and other blatant examples of criminal insider misconduct fall into this category. Predictably, the Commission would require courts to impose the most severe penalties on third level offenders because of the high standard of intent that the prosecution must establish.[117] Federal prosecutors, however, should not have difficulty meeting the knowing or purposeful *mens rea* standard when attempting to convict bank insiders for planned and deliberate criminal activity because written or oral evidence of the crime most likely will be available in situa-

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109. This model would conform to the standards for determining *mens rea* that the American Law Institute outlined in the Model Penal Code. MODEL PENAL CODE § 2.02(2)(b), (8) (Proposed Official Draft 1962).

110. *See* UNITED STATES NATIONAL COMM'N ON REFORM OF FEDERAL CRIMINAL LAWS, STUDY DRAFT OF A NEW FEDERAL CRIMINAL CODE 69-70 (1970). This statutory presumption would encourage bankers and other people connected with the banking industry to be aware of potential criminal liabilities.

111. *See, e.g.*, United States v. Gregory, 730 F.2d 692 (11th Cir. 1984); United States v. Luke, 701 F.2d 1104 (4th Cir. 1983); United States v. Adamson, 700 F.2d 953 (5th Cir.), *cert. denied*, 104 S. Ct. 116 (1983); United States v. Wilson, 500 F.2d 715 (5th Cir. 1974), *cert. denied*, 420 U.S. 977 (1975); United States v. Fortunato, 402 F.2d 79 (2d Cir. 1968), *cert. denied*, 394 U.S. 933 (1969); Logsdon v. United States, 253 F.2d 12 (6th Cir. 1958).

112. FINAL REPORT, *supra* note 98, at 75 (§ 1006(2)(c)).

113. *Id.*

114. *See, e.g.*, United States v. Hansen, 701 F.2d 1215 (7th Cir. 1983); *supra* text accompanying notes 59-61 (discussing *Hansen*).

115. The Eighth Circuit recently defined check kiting:

> Check kiting is a plan wherein one or more parties, utilizing checking accounts at two or more banks systematically exchange checks of similar amounts. Utilizing the delay or lag time as the checks are cleared through the Federal Reserve System, an inflated and uncollected balance is created and maintained at the banks. While checks drawn against uncollected funds are in the clearing process, the parties have the use of the deposited but uncollected funds, which make up the "float."

United States v. Young, 618 F.2d 1281, 1284 n.2 (8th Cir.), *cert. denied*, 449 U.S. 844 (1980); *see also* United States v. Mullins, 355 F.2d 883 (7th Cir.), *cert. denied*, 384 U.S. 942 (1966).

116. *See, e.g.*, United States v. Caldwell, 544 F.2d 691 (4th Cir. 1976).

117. *See* FINAL REPORT, *supra* note 98, at 75 (§ 1006(2)(c)).

tions involving persistent misconduct.

The Commission's proposed revisions to Title 18 would provide flexibility in section 656 cases and would equate the level of punishment with the defendant's level of *mens rea*. As one critic of section 656 has argued, "it cannot be gainsaid that the banker who has embezzled his bank's funds outright is, under the present statute, treated equally with those who have merely exceeded the confines of prudent banking, for admittedly personal gain, but with no risk that the bank would lose the funds."[118] The tri-level approach that the National Commission on Reform of Federal Criminal Laws advocates could serve as a model for redrafting the Misapplication Statute.[119] Congress then could tailor section 656 to provide for prosecutorial flexibility and to establish a just system of retribution in which the sanction corresponds to the degree of criminal responsibility.

B. The Short-Term Solution: Judicial Uniformity

The circuit courts have applied the Misapplication Statute inconsistently.[120] Despite the *Adamson* court's declaration that the circuit courts uniformly have adopted knowledge as the appropriate *mens rea* standard,[121] the circuit courts interpret the requisite intent standard of section 656 differently.[122] Equitable treatment of all potential section 656 violators requires the application of a uniform standard of judging criminal intent under the statute. Circuit courts, therefore, must decide whether reckless disregard of the bank's interests is the equivalent of the intent to injure or defraud the bank.

Courts have established that the specific intent to injure or defraud the bank is an element of the crime of misapplication.[123] The Supreme Court has determined that the prosecution may satisfy this element of a criminal offense by demonstrating either

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118. Cox, *supra* note 6, at 844.

119. Adapting the Commission's proposal to serve the interests of § 656 would require a major legislative effort including the establishment of new punishment standards and the possible drafting of two new statutes: one statute providing for a misdemeanor offense and the other providing for a felony offense.

120. *See supra* note 90; *supra* notes 51-52 and accompanying text.

121. *See supra* text accompanying note 90.

122. *See supra* notes 59-95 and accompanying text (discussing the Fourth, Fifth, and Seventh Circuits' approaches).

123. *See* Seals v. United States, 221 F.2d 243, 245 (8th Cir. 1955); United States v. Logsdon, 132 F. Supp. 3, 5 (W.D. Ky. 1955), *aff'd*, 253 F.2d 12 (6th Cir. 1958).

knowing or purposeful conduct.[124] Circuit courts that currently allow recklessness to satisfy section 656 criminal intent, therefore, may be conflicting with Supreme Court precedent.[125] At the very least, acceptance of a recklessness standard under the Misapplication Statute contradicts the Supreme Court's interpretation of specific intent.

Strong policy reasons justify a uniform rejection of the recklessness standard. The business of banking requires that people

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124. *See* United States v. Bailey, 444 U.S. 394, 405 (1980) (discussing the appropriate *mens rea* standard for satisfying the statutory requirement that an escaped prisoner must intend to avoid confinement). The *Bailey* Court relied on the traditional approach to specific intent crimes. The Court quoted from the criminal law treatise of Professors LaFave and Scott: "In a general sense, 'purpose' corresponds loosely with the common-law concept of specific intent, while 'knowledge' corresponds loosely with the concept of general intent." *Id.* at 405 (citing W. LAFAVE & A. SCOTT, *supra* note 101, § 28, at 201-02).

The Court also relied on the new approach to specific intent crimes that the American Law Institute adopted in the Model Penal Code. Section 2.02(2) of the Code defines the general requirements of culpability:

> (2) *Kinds of Culpability Defined.*
>
> (a) *Purposely.*
>
> A person acts purposely with respect to a material element of an offense when:
>
> (i) if the element involves the nature of his conduct or a result thereof, it is his conscious object to engage in conduct of that nature or to cause such a result; and
>
> (ii) if the element involves the attendant circumstances, he is aware of the existence of such circumstances or he believes or hopes that they exist.
>
> (b) *Knowingly.*
>
> A person acts knowingly with respect to a material element of an offense when:
>
> (i) if the element involves the nature of his conduct or the attendant circumstances, he is aware that his conduct is of that nature or that such circumstances exist; and
>
> (ii) if the element involves a result of his conduct, he is aware tbat it is practically certain that his conduct will cause such a result.
>
> (c) *Recklessly.*
>
> A person acts recklessly with respect to a material element of an offense when he consciously disregards a substantial and unjustifiable risk that the material element exists or will result from his conduct. The risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation.
>
> (d) *Negligently.*
>
> A person acts negligently with respect to a material element of an offense when he should be aware of a substantial and unjustifiable risk that the material element exists or will result from his conduct. The risk must be of such a nature and degree that the actor's failure to perceive it, considering the nature and purpose of his conduct and the circumstances known to him, involves a gross deviation from the standard of care that a reasonable person would observe in the actor's situation.

MODEL PENAL CODE § 2.02(2) (Proposed Official Draft 1962).

125. One interpretation of United States v. Bailey, 444 U.S. 394 (1980), is that the Supreme Court held that specific intent crimes require purposeful conduct.

who make decisions about credit allocation and asset valuation base their decisions on tangible as well as intangible factors.[126] A banker who does not take risks is not serving a productive societal function.[127] The Fifth Circuit, in advocating the uniform rejection of the recklessness standard for section 656, stated: "[W]e do not believe that Congress intended that bank employees engaged in routine transactions, such as making book entries or making loans, should be exposed to felony prosecutions unless they act knowingly."[128]

The Fifth Circuit, in rejecting the recklessness standard for the prosecution of section 656 cases, made several persuasive observations. The knowledge or purpose that courts require for *mens rea* under the predecessor statute to section 656, absent congressional intent to the contrary, should carry over to section 656.[129] In addition, the *mens rea* requirement of knowledge that courts uniformly apply to section 1005, the companion statute to section 656, also should be applied to section 656.[130] The similar substantive provisions of the two statutes logically call for similar *mens rea* requirements. Finally, permitting courts to hold that recklessness satisfies the *mens rea* test of section 656 violates constitutional due process.[131] The remaining ten circuits should rely on the same policy reasons that the Fifth Circuit used to reject the recklessness standard.[132]

Admittedly, if courts uniformly reject the recklessness standard and adopt the knowledge test for section 656 intent, prosecutors would have more difficulty obtaining section 656 convictions under this heightened *mens rea* standard.[133] In particular, the government lacks the flexibility to prosecute in cases in which the de-

126. *See generally* M. MAYER, *supra* note 43, at 296-357 (discussing the credit allocation function of bankers).

127. *See id.* at 296.

128. United States v. Adamson, 700 F.2d 953, 965 (5th Cir.), *cert. denied*, 104 S. Ct. 116 (1983).

129. *See supra* note 89 and accompanying text.

130. *See supra* notes 92-93 and accompanying text.

131. *See supra* notes 35-41 and accompanying text.

132. *See Adamson*, 700 F.2d at 965. In the most recent case to rule on the § 656 *mens rea* standard, the Eleventh Circuit relied on the Fifth Circuit's reasoning in *Adamson* to support a determination that "the appropriate *mens rea* standard for section 656 is knowledge." United States v. Gregory, 730 F.2d 692, 702 (11th Cir. 1984); *see supra* note 50.

133. Assuming the circuit courts restricted § 656 *mens rea* to knowledge, federal prosecutors would experience difficulty in obtaining convictions in situations arising from lending irregularities because lending irregularities are unlikely to indicate the accused's intent. *See generally* O'Malley, *supra* note 4, at 108-10 (discussing cases arising from lending irregularities).

fendant acted recklessly, but the facts do not reveal the degree of his knowledge or intent.[134] These borderline defendants, however, should not be subject to the severe criminal penalties that section 656 imposes. Numerous statutes already provide civil liabilities for acts of maladministration by bank personnel.[135] In fact, limiting the number of prosecutions under section 656 to knowing violations might spur Congress to redraft a more comprehensive version of the Misapplication Statute.

V. CONCLUSION

The most immediate problem facing bankers, attorneys, and judges addressing section 656 questions is the inconsistent application of the *mens rea* element of the Misapplication Statute. The most recent circuit court decisions interpreting the Misapplication Statute illustrate the lack of uniformity in the application of the section 656 *mens rea* standard. Most bankers are unaware of the potential criminal liability that they may face for reckless misapplication of funds.[136] Even for bankers who are aware of potential section 656 liability, the fact that current banking practices regularly transcend state borders accentuates the need for uniform regulation of banking conduct with national judicial enforcement standards.

In an effort to ensure fair prosecution and adequate control of the wide variety of illegal practices that occur in the banking industry, Congress should amend section 656 to allow prosecutors greater flexibility when they charge bankers with criminal violations. Until Congress decides to redraft section 656, however, the courts should strive to meet the short-run objective of establishing a uniform standard of culpability. To promote an efficient banking

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134. *See, e.g.*, United States v. Luke, 701 F.2d 1104 (4th Cir. 1983); United States v. Adamson, 700 F.2d 953 (5th Cir.), *cert. denied*, 104 S. Ct. 116 (1983).

135. Statutes imposing civil liabilities on bank personnel for insider misconduct include: 12 U.S.C. §§ 84 (violations of bank lending limits), 371 (limitations on real estate loans), 371c (restrictions on transactions with banking affiliates), 375a (limitations on loans to executive officers of banks), 376 (limitations on rates of interest paid to bank directors) (1982).

136. For example, the American Banking Association's handbook for bank officials erroneously assures bank personnel that to commit the violation of misapplication of bank funds, "the misapplication must be 'willful.'" SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, OVERDRAFTS AND CORRESPONDENT BANKING PRACTICES 677 (Comm. Print 1977).

system, the courts should adopt knowledge as the minimum *mens rea* standard for sustaining criminal convictions under the Misapplication Statute.

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