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Donald M. Ferencz

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# ***People v. Kagan* and New York Banking Law Section 673: A Study in Misapplication**

## I. Introduction

Section 673 of the New York Banking Law,<sup>1</sup> which criminalizes the wilful misapplication of bank funds by officers or employees, recently received some much-needed clarification in the case of *People v. Kagan*.<sup>2</sup> The New York Court of Appeals, in dismissing felony indictments based on that statute, held that, absent fraudulent intent or self-dealing, the infraction of civil banking regulations does not constitute a crime.<sup>3</sup> The decision, vindicating three former officers of the now defunct American Bank & Trust Company (ABT), delimits the scope of what is meant by "wilful misapplication," a term left undefined by the Banking Law, and thereby reduces the risk of criminal prosecution for New York bankers who err in the ordinary course of business.

This note considers the legislative history of the mens rea and transactional requirements of section 673 and the rather limited prior case law interpreting the statute. After analyzing the *Kagan* decision in light of this background, this note concludes that the result reached in *Kagan* brings New York's misapplication statute into closer conformity with its federal coun-

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1. Section 673 of the Banking Law provides:

Any officer, director, trustee, employee or agent of any corporation to which the banking law is applicable, or any employee or agent of any private banker, who abstracts or wilfully misapplies any of the money, funds or property of such corporation or private banker, or wilfully misapplies its or his credit, is guilty of a felony. Nothing in this section shall be deemed or construed to repeal, amend or impair any existing provision of law prescribing a punishment for any such offense.

N.Y. BANKING LAW § 673 (McKinney 1971).

2. 56 N.Y.2d 193, 436 N.E.2d 1274, 451 N.Y.S.2d 672 (1982).

3. *Id.* at 204, 436 N.E.2d at 1278, 451 N.Y.S.2d at 676. The civil regulations in question, §§ 103(1), 103(8), and 106 of the Banking Law, are described more fully *infra* at note 9.

terpart,<sup>4</sup> consequently restricting section 673's applicability to the type of criminal conduct envisioned by its drafters.

## II. Background

### A. *The Facts*

In the years 1975-76, ABT was acquired by the Graivers, a prominent Argentinian banking family.<sup>5</sup> During this period, ABT engaged in a variety of transactions whereby money was loaned to and deposited with several other financial institutions controlled by the Graivers.<sup>6</sup> None of the questioned transactions resulted in any loss to ABT or any gain to the defendants,<sup>7</sup> who served there in executive and management positions.<sup>8</sup> A number of the transactions, however, exceeded the limits imposed by sections 103(1), 103(8), and 106 of New York's Banking Law, regulating bank loans and transfers.<sup>9</sup> On the basis of these viola-

4. The federal misapplication statute states, in pertinent part:

Whoever being an officer, director, agent or employee of . . . [a nationally chartered bank] . . . 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 . . . [shall be guilty of a felony].

18 U.S.C. § 656 (1976).

5. *People v. Kagan*, 56 N.Y.2d at 201, 436 N.E.2d at 1276, 451 N.Y.S.2d at 674.

6. The transactions consisted of "time deposits, the purchase of foreign checks, overdrafts, grants of immediate credit on domestic checks, and sales of federal funds." *People v. Kagan*, 83 A.D.2d 517, 519, 441 N.Y.S.2d 256, 259 (1st Dep't 1981) (Kupferman, J., dissenting) (mem.).

7. *People v. Kagan*, 56 N.Y.2d at 202, 436 N.E.2d at 1277, 451 N.Y.S.2d at 675.

8. The defendants included the chairman of the board of ABT's holding company, who also served as an executive officer and director of ABT; a senior manager who headed ABT's international division; and a director of both ABT and its holding company. *People v. Kagan*, 56 N.Y.2d at 200-01, 436 N.E.2d at 1276, 451 N.Y.S.2d at 674.

David Graiver, as owner of the bank and the prime mover behind the transactions in question was unavailable for trial, having been presumed killed in a plane crash over Mexico in August 1976. *People v. Kagan*, 83 A.D.2d at 519, 441 N.Y.S.2d at 259 (Kupferman, J., dissenting).

9. Section 103(1) limits the amount that a bank may loan to a single borrower to 10% of its capital stock, surplus fund, and undivided profits, N.Y. BANKING LAW § 103(1) (McKinney Supp. 1982), allowing a 25% limit if the loan is secured, N.Y. BANKING LAW § 103(1)(c) (McKinney 1971).

Section 103(8) limits the amount that can be loaned to a director or director-controlled entity by requiring approval of the board of directors of the lending bank. *Id.* § 103(8).

Section 106 limits the amount that one bank may deposit with a depository bank to 10% of the depositing bank's capital stock, surplus funds, and undivided profits. Up to

tions, two of the bank's officers were tried by a jury and convicted of felonious misapplication of bank moneys or credit pursuant to section 673.<sup>10</sup>

On appeal to the appellate division, first department, the defendants argued 1) that intent to injure or defraud is a necessary element of the offense of wilful misapplication; and 2) that imposing penal sanctions for violations of civil regulations is unconstitutional, since the civil provisions do not give fair notice that their infraction constitutes a crime.<sup>11</sup> The appellate division affirmed the convictions,<sup>12</sup> relying on *People v. Marcus*,<sup>13</sup> a prior case, which held that fraudulent intent is not an element of the crime of wilful misapplication. A strong dissent by Judge Kupferman, however, decried the prosecution of defendants whom he characterized as "scapegoats in this tangled affair."<sup>14</sup>

## B. Legislative History

New York's misapplication statute was originally enacted in 1913<sup>15</sup> to provide depositors of State chartered banks a degree of protection commensurate with that afforded depositors of nationally chartered banks.<sup>16</sup> The federal misapplication statute, governing national banks,<sup>17</sup> had been in effect since the passage

25% may be deposited with the approval of a majority vote of the directors, and up to 200% if, in addition to the directors' approval, the Superintendent of Banks approves and the depository bank is a New York bank. N.Y. BANKING LAW § 106 (McKinney 1971).

10. *People v. Kagan*, 56 N.Y.2d 193, 436 N.E.2d 1274, 451 N.Y.S.2d 672 (1982). One defendant pleaded guilty, preserving the intent question on appeal. *Id.* at 193, 436 N.E.2d at 1274, 451 N.Y.S.2d at 672.

11. *People v. Kagan*, 83 A.D.2d 517, 441 N.Y.S.2d 256 (1st Dep't 1981).

12. *Id.* at 517, 441 N.Y.S.2d at 257.

13. 261 N.Y. 268, 185 N.E. 97 (1933), discussed *infra.* at text accompanying notes 31-42.

14. *People v. Kagan*, 83 A.D.2d at 522, 441 N.Y.S.2d at 261 (Kupferman, J., dissenting).

15. The statute was enacted as 1913 N.Y. Laws ch. 102. At the time of its ratification it was designated former N.Y. PENAL LAWS § 305, repealed by PENAL LAW 1965 § 500.95. In 1965, the statute was redesignated as § 673 of the BANKING LAW, 1965 N.Y. Laws ch. 1031 § 18. To avoid confusion, the statute will hereinafter be referred to simply as the misapplication statute.

16. See *infra* notes 28-29 and accompanying text.

17. The federal-state regulatory dichotomy is the result of the dual banking system which exists in the United States. Banks which operate under federal charter are governed primarily by federal regulations whereas state chartered banks are subject to regu-

of the National Bank Act in 1864.<sup>18</sup> The Act made it a crime for any bank officer or employee to wilfully misapply bank moneys with the intention of injuring or defrauding the bank or any other individual or association.<sup>19</sup> The Act failed, however, to define the term "wilful misapplication."

In response to this deficiency, the Supreme Court, in *United States v. Britton*,<sup>20</sup> construed wilful misapplication as a "misapplication for the use, benefit, or gain of the party charged, or of some company or person other than the [bank]."<sup>21</sup> The Court, in *Evans v. United States*,<sup>22</sup> further elucidated its understanding of wilful misapplication, stating that intent to injure or defraud is the "gravamen of the offense."<sup>23</sup> Thus, a distinction was drawn between mere maladministration, for which civil penalties might lie, and wilful misapplication, punishable by up to ten years imprisonment.<sup>24</sup>

Due to the nature of the dual banking system, the federal provisions were not enforceable against officers or employees of State chartered banking institutions.<sup>25</sup> Therefore, in 1913, at the request of New York Governor Sulzer,<sup>26</sup> the Superintendent of Banks, George Van Tuyl, Jr., proposed legislation to bring New York's banking laws "more in harmony with the reading of the

lations legislated by the states. For a general discussion of the dual banking system see Willie, *State Banking: A Study in Dual Regulation*, 31 LAW & CONTEMP. PROBS. 733 (1966).

18. See 13 Stat. 116 § 55 (1864): "every president, director, cashier, teller, clerk, or agent of any association, who shall embezzle, abstract, or wilfully misapply any of the moneys, funds, or credits of the association . . . with intent . . . to injure or defraud the association or any other company, body politic or corporate, or any individual person . . . 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." *Id.* (codified as amended in 18 U.S.C. § 656 (1976)).

19. See *id.*

20. 107 U.S. 655 (1883).

21. *Id.* at 666.

22. 153 U.S. 584 (1894).

23. *Id.* at 594 ("[i]n fact, the gravamen of the offence [of wilful misapplication] consists in the evil design with which the misapplication is made, and a count which should omit the words 'wilfully,' etc., and 'with intent to defraud,' would be clearly bad").

24. See *supra* note 18.

25. See *supra* note 17. See generally Hackley, *Our Baffling Banking System*, 52 VA. L. REV. 565 (1966) (examining the enforcement and problems of the Federal Reserve System and regulatory agencies); Golembe, *Our Remarkable Banking System*, 53 VA. L. REV. 1091 (1967) (a further examination of the conflicts in the federal banking system).

26. See PUBLIC PAPERS OF WILLIAM SULZER, GOVERNOR 738 (1914).

provisions of the National Banking Act.”<sup>27</sup>

When the legislature adopted New York’s misapplication statute, it retained the federal “wilfully misapplies” language, but did not expressly include the federally required element of fraudulent intent.<sup>28</sup> Despite the omission of the fraudulent intent language, Van Tuyl expressed his understanding that the new statute was aimed at protecting “depositors who have been wronged and *defrauded* by officers of institutions in which they have had their confidence.”<sup>29</sup> Van Tuyl’s remarks to the Legislature subsequent to the statute’s enactment do not indicate that he perceived any difference between the crime contemplated by the New York statute and that contemplated by the federal model upon which it was patterned. He expressed his satisfaction that “acts which would have been speedily and severely punished under the National Banking Act” would no longer go unpunished in New York.<sup>30</sup>

27. 1912 SUP’T OF BANKS ANN. REP. 21.

28. See *supra* notes 1 & 18 (setting forth the State and federal statutes).

In interpreting the deletion of the phrase “with intent to injure or defraud,” it should be noted that in 1882 the New York Legislature demonstrated an apparent dissatisfaction with a criminal definition of the word “wilful” which omitted the element of injurious or fraudulent intent. Compare former N.Y. PENAL CODE § 718 (1881) with 1882 N.Y. Laws, ch. 384, § 718 (in 1882 the legislature expunged the following definition from the statutes of New York, after it had been on the books for less than a year: “Each of the terms “wilful” and “wilfully” imports a purpose of willingness to commit the act or omission to which it refers, and does not require any specific intent to violate law, to injure another, or to acquire any advantage”).

In 1948, Congress, too, deleted the phrase requiring fraudulent intent from the federal misapplication statute. This deletion was made, not to remove the well-established requirement of fraudulent intent, but rather to avoid unnecessary verbiage. See S. REP. No. 1620, 80th Cong., 2d Sess. 1-4 (1948).

29. 1913 SUP’T OF BANKS ANN. REP. 33 (emphasis added). Van Tuyl reported that [c]hapter 102 of the Laws of 1913 transfers to the law of this state one of the most valuable provisions of the National Banking Act, with relation to crimes *against* banking institutions committed by officers, directors, employees or agents thereof.

In the various attempts which have been made to punish the officers of failed institutions in New York City and Brooklyn, it was found impossible to convict for acts which would have been speedily and severely punished under the National Banking Act.

*Id.* (emphasis added).

It is interesting to note that Van Tuyl apparently understood the misapplication statute to apply to crimes *against* banks. His report made no mention of civil infractions committed *on behalf* of banks.

30. *Id.*

### C. *Early Cases*

In 1933, the seminal case interpreting New York's misapplication statute, *People v. Marcus*,<sup>31</sup> held that where funds have been used for other than corporate purposes, fraudulent intent is not required to convict for wilful misapplication.<sup>32</sup> In *Marcus*, a misapplication occurred when the directors of the Municipal Safe Deposit Company (Company), to which the misapplication statute applied, used funds for purposes *other* than those of the Company.<sup>33</sup>

The *Marcus* defendants were directors of both the Company and the Bank of United States, the latter being a totally distinct enterprise.<sup>34</sup> The bank, having made loans in excess of the civil regulatory limit to several of its affiliates, faced the possibility of civil penalties.<sup>35</sup> In order to reduce the amount of the excessive loans, the defendants devised a scheme whereby they would use their influence as directors of the Company to have it engage in a transaction designed to benefit the bank. In order to assist the bank and thereby advance their interests as its directors, the defendants acted in their separate capacity as directors of the Company and arranged to have it purchase stock of the affiliates to which the excessive loans had been made.<sup>36</sup> The proceeds of the sale were then used by the bank's affiliates to repay money which the affiliates owed the bank.<sup>37</sup> The stock purchase was arranged, not to defraud the Company, but solely to help bring the bank's excessive loans to the affiliates within the regulatory limit.<sup>38</sup> Since the transaction served no legitimate business interest of the Company, the defendants, as its directors, were held to have misapplied its funds by using them for purposes other than those of the Company.<sup>39</sup> Thus, the *Marcus* de-

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31. 261 N.Y. 268, 185 N.E. 97 (1933).

32. *Id.* at 279, 185 N.E. at 99.

33. *Id.* at 281, 185 N.E. at 99-100.

34. *Id.* at 284, 185 N.E. at 101.

35. *Id.* at 286-87, 185 N.E. at 101-02. Though not an issue in the criminal prosecution of the *Marcus* defendants, it should be noted that at the time of the stock purchase, the bank's outstanding loans exceeded the permissible regulatory limits.

36. *Id.* at 287, 185 N.E. at 102.

37. *Id.* at 288, 185 N.E. at 102.

38. *Id.* at 289-90, 185 N.E. at 103.

39. *Id.* at 289, 185 N.E. at 103.

endants were convicted of criminal misapplication even though they neither intended nor caused any injury by the prohibited transaction.<sup>40</sup>

The *Marcus* prosecution did not focus on the impropriety of the concededly excessive loans which the bank had made to its affiliates, but rather on the ultra vires nature of the stock purchase made on behalf of the Company.<sup>41</sup> The *Marcus* court, therefore, never addressed the question of whether the infraction of civil lending regulations, by itself, amounts to criminal misapplication. Instead, the court focused on the stock purchase and considered it a direct criminal misapplication of funds.<sup>42</sup>

A year later, in *People v. Berardini*,<sup>43</sup> a New York trial court broadly construed the the word "misapply," and held, as a matter of law, that if a loan exceeds the statutory limit, such loan constitutes a criminal misapplication.<sup>44</sup> In examining the mens rea requirements of criminal misapplication, the *Berardini* court, following *Marcus*, stated that "honest motives" are irrelevant.<sup>45</sup>

#### D. *People v. Kagan: The Appellate Decision*

The appellate division in *Kagan*, following its understanding of the prior cases, held that evil intent is not a prerequisite to conviction under section 673 of the New York Banking Law.<sup>46</sup> The majority found that the verdict of the trial court was "in

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40. *Id.* A civil suit was subsequently brought against the Bank of United States' directors for the civil infractions of the banking regulations. See *Broderick v. Marcus*, 152 Misc. 413, 272 N.Y.S. 455 (N.Y. Mun. Ct. 1934). Moreover, *Broderick* announced that "the decisions of the United States Supreme Court, based upon the National Banking Act and the duty of directors of national banks, are fully applicable in State courts." *Id.* at 417, 272 N.Y.S. at 460 (emphasis added).

41. *People v. Marcus*, 261 N.Y. at 276, 185 N.E. at 97-98.

42. For a discussion criticizing the result in *Marcus* as unduly harsh, see J. GOODBAR, *MANAGING THE PEOPLE'S MONEY* 130-35 (1935) (where New York's misapplication statute was characterized as "sadly in need of revision"). But see Fitzsimons, *Recent Criminal Cases*, 24 J. CRIMINOLOGY & POLICE Sci. 774 (1933) (calling for stiffer criminal sentences to deter misconduct by bankers).

43. 150 Misc. 311, 269 N.Y.S. 381 (1934).

44. *Id.* at 314, 269 N.Y.S. at 384-5. In *Berardini*, the issue was whether a particular advance constituted an excessive loan. The court ruled that this was a question for the jury. *Id.* at 317-18, 269 N.Y.S. at 387-9.

45. *Id.* at 314, 269 N.Y.S. at 384.

46. *People v. Kagan*, 83 A.D.2d 517, 441 N.Y.S.2d 256 (1st Dep't 1981).

accordance with the clear meaning of the statutory language, that a [section 673] violation occurs when bank officials knowingly apply bank money or credit in a manner explicitly prohibited by statutory provisions."<sup>47</sup> Thus, for purposes of satisfying section 673, the court equated the word "wilfully" with the word "knowingly."

Although the question had never been put to the jury, the majority concluded that the defendants had used ABT's assets for "other than corporate purposes or proper and legitimate investment."<sup>48</sup> Despite its holding that an intention to benefit personally is not relevant to such a prosecution, the court indicated that the motivation to accommodate ABT's new owners by liberally extending credit sufficiently demonstrated that the defendants acted out of concern for their own private interests.<sup>49</sup>

Judge Kupferman, dissenting, observed that the defendants had all acted in good faith, relying on "long-standing banking practices and policies."<sup>50</sup> All excessive transfers to other banks were repaid the next business day; all alleged overdrafts were repaid with interest; and no check purchased went uncollected.<sup>51</sup> For these reasons, and considering that none of the defendants stood to gain in any way from the transactions, Judge Kupferman concluded that there was insufficient evidence of criminal intent to support the charges.<sup>52</sup>

The dissent also found that *Marcus* was readily distinguishable. Contrary to the majority's factual determination, the dissent asserted that the defendants in *Kagan*, unlike those in *Marcus*, did not act in their own self interest, nor for other than corporate purposes. Therefore, according to the dissent, the *Marcus* holding that fraudulent intent is not required for conviction should have been narrowly construed and confined to its own particular set of facts.<sup>53</sup> Judge Kupferman further noted that the *Kagan* convictions were reversible on the basis of the impermissible imposition of section 673's penal sanctions for the

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47. *Id.* at 517, 441 N.Y.S.2d at 257.

48. *Id.*

49. *Id.* at 518, 441 N.Y.S.2d at 257.

50. *Id.* at 520, 441 N.Y.S.2d at 259 (Kupferman, J., dissenting).

51. *Id.* at 519, 441 N.Y.S.2d at 259 (Kupferman, J., dissenting).

52. *Id.* at 521, 441 N.Y.S.2d at 261 (Kupferman, J., dissenting).

53. *Id.* at 521, 441 N.Y.S.2d at 260-261 (Kupferman, J., dissenting).

infraction of sections 103 and 106.<sup>54</sup> He concluded that, since the civil regulations give no warning of penal consequences, a person of "ordinary intelligence" would not have the constitutionally mandated "fair notice that his contemplated conduct is forbidden by statute."<sup>55</sup>

### III. The *Kagan* Decision

The court of appeals reversed, adopting, in part, the reasoning of Judge Kupferman's dissent.<sup>56</sup> In an opinion written by Chief Judge Cooke,<sup>57</sup> the court noted 1) that none of the regulatory provisions cited prescribe penal sanctions;<sup>58</sup> 2) that ABT suffered no losses due to the questioned transactions; and 3) that none of the defendants stood to benefit from the transactions.<sup>59</sup> The court, narrowly interpreting *Marcus*, concluded that conviction for wilful misapplication does not necessarily require an intent to injure or defraud, but does require something more

54. *Id.* at 520, 441 N.Y.S.2d at 259-60 (Kupferman, J., dissenting). For federal cases failing to impose criminal sanctions for civil infractions, see *United States v. Britton*, 107 U.S. 655 (1882), quoted *supra* at text accompanying note 21; *United States v. Christo*, 614 F.2d 486 (5th Cir. 1980) (an insider overdrafting case, which held that use of funds in a manner unauthorized or prohibited by the federal banking statutes does not, without more, constitute criminal misapplication). For a discussion supporting the result in *Christo*, see Schwind, *Sinister Hybrid—Civil Constraint and Criminal Liability—A New Application and the Fifth Circuit's Response*, 97 BANKING L. J. 645 (1980).

55. *People v. Kagan*, 83 A.D.2d at 520, 441 N.Y.S.2d at 260 (Kupferman, J., dissenting) (citing *Papachristou v. City of Jacksonville*, 405 U.S. 156, 162 (1972)).

56. *People v. Kagan*, 56 N.Y.2d 193, 436 N.E.2d 1274, 451 N.Y.S.2d 672 (1982). Since the case was decided on the basis of the factual differences between *Kagan* and *Marcus*, the court failed to reach the constitutional due process issue raised in Kupferman's dissent.

57. Chief Judge Cooke wrote the majority opinion, joined by Judges Gabrielli, Wachtler, Fuchsberg, Jones and Meyer. Judge Jasen dissented without opinion. *Id.* at 199, 436 N.E.2d at 1275, 451 N.Y.S.2d at 673.

58. Though the court did not recite them, there are many civil provisions of the Banking Law which make specific reference to *civil* penalties only. See, e.g., § 103(8) (forfeiture of twice the amount of the violative loan); § 104(5) (monetary fine for failure to comply with record-keeping procedures); § 107 (monetary assessment for failure to maintain proper reserves); § 123 (monetary penalty for failure to file reports with the Superintendent of Banks). See also N.Y. BANKING LAW §§ 125, 130, 176, 255, 258, 320, 329, 352, 513, and 605 (McKinney 1971); N.Y. BANKING LAW §§ 131, 202 (McKinney Supp. 1982).

59. *People v. Kagan*, 56 N.Y.2d at 199-200, 436 N.E.2d at 1275-76, 451 N.Y.S.2d at 673-74.

than a mere knowing violation of a civil regulation.<sup>60</sup>

Citing former Superintendent of Banks Van Tuyl's 1912 report to the Legislature, the court recognized that section 673's predecessor was introduced in an effort to harmonize New York's banking laws with the Federal National Banking Act.<sup>61</sup> Rather than dwelling on the New York statute's omission of the federal requirement of fraudulent intent, the court focused on the transactional nature of the offense. The court, citing *Britton*<sup>62</sup> and *Marcus*,<sup>63</sup> held that wilful misapplication requires a use for the benefit of some party or company *other* than the bank.<sup>64</sup> The court concluded that unless there is such a conversion, the infraction of civil regulations does not amount to misapplication.<sup>65</sup>

More specifically, the court ruled that a criminal misapplication requires "personal pecuniary interest" in the transaction. Disagreeing with the appellate division, the court noted that such "incidental bounty" as the gratitude of a well-served client or bank owner will not justify criminal penalties.<sup>66</sup> The court reasoned that since the defendants acted "without any suggestion of personal profit," there was simply no basis for the indictments.<sup>67</sup>

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60. *Id.* at 202, 436 N.E.2d at 1277, 451 N.Y.S.2d at 675. In particular, the court stated that:

The primary question to be decided is the meaning of "wilful misapplication" — i.e., what is the nature of the *mens rea*, if any, that must be alleged and proven in order to sustain a prosecution for violating section 673. The People urge that a knowing violation of the Banking Law's civil regulations suffices to establish a wilful misapplication. On the other hand, defendants argue that an actual intent to injure or defraud a bank is necessary. While it is concluded the People too broadly interpret section 673, the defendant's construction similarly is found to be overly narrow.

*Id.* at 203, 436 N.E.2d at 1277, 451 N.Y.S.2d at 675.

61. *Id.* See *supra* notes 29-30 and accompanying text.

62. *United States v. Britton*, 107 U.S. 655 (1883). See *supra* notes 20-21 and accompanying text.

63. *People v. Marcus*, 261 N.Y. 268, 185 N.E. 97 (1933). See *supra* notes 31-42 and accompanying text.

64. *People v. Kagan*, 56 N.Y.2d at 203-04, 436 N.E.2d at 1278, 451 N.Y.S.2d at 675-76.

65. *Id.* at 204, 436 N.E.2d at 1278, 451 N.Y.S.2d at 676.

66. *Id.*

67. *Id.*

## IV. Analysis

In *Kagan*, the court of appeals reiterated the *Marcus* court's holding that criminal misapplication occurs when a banking institution's funds are applied for other than corporate purposes.<sup>68</sup> In specifying that non-corporate use is a transactional prerequisite to criminal misapplication,<sup>69</sup> however, the *Kagan* decision significantly limits section 673's applicability. The decision in *Kagan*, therefore, signals a retreat from the expansive reading of New York's misapplication statute evidenced in both *Berardini*, where excessive lending was deemed criminal per se,<sup>70</sup> and in the appellate division's decision in *Kagan*, which held that violating civil regulations to accommodate ABT's new owners went far enough beyond the realm of legitimate corporate purposes to warrant conviction.<sup>71</sup>

By focusing primarily on the transactional nature of the offense of wilful misapplication, the *Kagan* court circumvented the question of the precise meaning of the term "wilfully" as it applies to the mens rea requirement of section 673. The appellate division, in affirming the conviction of the *Kagan* defendants, reasoned from what it characterized as the "clear meaning of the statute," that, for purposes of satisfying section 673, the word "wilfully" is synonymous with the word "knowingly."<sup>72</sup>

68. *People v. Marcus*, 261 N.Y. 268, 185 N.E. 97 (1933). See *supra* notes 31-42 and accompanying text.

69. *People v. Kagan*, 56 N.Y.2d 193 at 204, 436 N.E.2d 1274 at 1278, 451 N.Y.S.2d at 676.

70. *People v. Berardini*, 150 Misc. 311, 269 N.Y.S. 381 (1934). See *supra* notes 43-45 and accompanying text. *Berardini's* finding that excessive loans are criminal per se overlooks not only the legislative history of the misapplication statute, (see *supra* notes 15-28 and accompanying text), but also the fact that in *Marcus*, concededly excessive loans were not criminally prosecuted. *People v. Marcus*, 261 N.Y. 268, 185 N.E. 97 (1933). Nor did the *Marcus* court, which took pains to demonstrate how a stock purchase could be deemed a criminal offense, give even the slightest indication that the misapplication charges could alternatively have been grounded in the excessive loans which precipitated the scheme. See *id.* at 268, 135 N.E. at 97.

71. *People v. Kagan*, 83 A.D.2d 517, 517-18, 441 N.Y.S.2d 256, 257 (1st Dep't 1981).

72. *Id.* at 517, 441 N.Y.S.2d at 257. See *supra* note 47 and accompanying text. To describe the meaning of the word "wilful" as "clear" is to overlook not only its characterization as a "largely undefined and frequently hazy adverbial term," (Note, *The Proposed Penal Law of New York: Culpability*, 64 COLUM. L. REV. 1469, 1481 (1964) (quoting Prop. Penal Law § 45.05, comm'n staff note), but also the truth of the observation that "wilful is a word of many meanings, its construction often being influenced by its context." *Screws v. United States*, 325 U.S. 91, 101 (1945). The over 1,000 definitions of

The court of appeals, however, rightfully rejected the appellate division's conclusion that the knowing infraction of bank lending regulations amounts to criminal misapplication.<sup>73</sup> The legislative history of section 673,<sup>74</sup> coupled with the Supreme Court's pronouncements in *Britton*<sup>75</sup> and *Evans*,<sup>76</sup> lends considerable weight to the argument that New York's legislature understood criminal misapplication to mean something more than the mere knowing infraction of civil regulations, encompassed by non-criminal maladministration. While the court of appeals' decision in *Kagan* does not go so far as to require actual fraudulent intent, it does require that there must be at least some material non-corporate purpose involved before the infraction of civil regulations will be deemed criminal. In this respect, the court's decision tends decidedly toward conformity with the federal transactional requirements of wilful misapplication.

Despite its recognition that the nature of the mens rea required for criminal misapplication was a central issue in the case, the *Kagan* court did not delineate the exact level of intent that is required. What the court did make clear, however, is that, absent self-dealing or a conscious intent to defraud, a banker who applies moneys for the benefit of his bank, even in violation of civil regulations, cannot be convicted of criminal misapplication.<sup>77</sup>

In evaluating the result reached in *Kagan*, one must consider that even honest bankers may fall prey to the intricacies of

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"wilful" or "wilfully" which are listed in 45 Words and Phrases 275-372 (1970) tends to reinforce the *Screws* court's conclusion.

Even the New York Court of Appeals has had occasion to read a requirement of evil intent into the term "wilful." See, e.g., *People v. Pickett*, 19 N.Y.2d 170, 176, 225 N.E.2d 509, 511-12, 278 N.Y.S.2d 802, 804-05 (1967). There, the court, interpreting the phrase "any wilful act designed to interfere with the proper administration of public assistance," held that "the Legislature meant to provide penal sanctions *only for acts motivated by fraudulent intent*. Since the defendant was neither charged with fraud nor was proof of fraud on his part introduced upon the trial, his conviction must be reversed." *Id.* (emphasis added).

73. *People v. Kagan*, 56 N.Y.2d 193, 436 N.E.2d 1274, 451 N.Y.S.2d 672 (1982).

74. See *supra* notes 15-30 and accompanying text.

75. *United States v. Britton*, 107 U.S. 655 (1883). See *supra* notes 20-21 and accompanying text.

76. *Evans v. United States*, 153 U.S. 584 (1894). See *supra* notes 22-24 and accompanying text.

77. *People v. Kagan*, 56 N.Y.2d 193, 436 N.E.2d 1274, 451 N.Y.S.2d 672 (1982).

banking regulations. In 1913, former Superintendent of Banks, Van Tuyl, expressed a sympathetic understanding for those who must operate within the regulatory challenges of New York's banking laws, stating:

[T]he banking law today is full of incongruities and ambiguities. In fact, the language used is in many instances both crude and prolix. So many of its provisions are capable of different interpretations that in order to know what the law with reference to any particular subject is it is necessary to have a comprehensive knowledge of the opinions of the Attorney General interpreting it rather than to be familiar with the law itself.<sup>78</sup>

Given the apparent difficulty that the courts have had in interpreting section 673, Van Tuyl's remarks regarding banking regulations retain a degree of validity even today. The *Kagan* decision at least diminishes the risk of criminal conviction for those who endeavor to operate under such regulations.

The *Kagan* court, having reversed on other grounds, correctly declined to reach the constitutional fair notice question. Yet section 673's lack of specificity as to the definition of wilful misapplication may continue to prove troublesome, not only for unwary bankers, but also for regulators attempting to deter abuses. Though the boundaries marked off in *Kagan* will help to minimize such potential difficulties, a more precise statutory definition is desirable.

## V. Conclusion

In narrowing the scope of conduct proscribed by section 673 to cases involving something more than the knowing infraction of civil regulations, the *Kagan* decision harmonizes New York's misapplication statute with its federal counterpart and reduces the risk of unwarranted prosecutions of bankers doing business in New York. The decision thereby alleviates some of the difficulties created by the legislative failure to clearly define the crime of wilful misapplication. Moreover, the *Kagan* decision

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78. N.Y. Times, June 2, 1913, at 14, col. 4.

raises the hope that, henceforth, section 673 will, itself, be less susceptible to misapplication.

*Donald M. Ferencz*