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FEDERAL LAW
RESEARCH

ERIC JASO
ATTORNEY WORK PRODUCT

2 U.S.C. § 441(b)

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stat of lims
18 USC 3282
5 yrs.

reg: 11 CFR § 114.2

2 USC § 441b – lim 5 yrs
§ 437g – penalties (subsec(d))

pr→ Barker 530 F2d 181 (8th 1975) → not a lesser incl. offense of 18 USC § 656.

Cort v Ash 422 US 66 (1975)
if state law permits corp contrib to state elections, s/h on notice → no recourse under Fed law (pvt rt of action case)

pr→ US v Clifford 409 FS 1070 (DCNY 1976)

→ def: "nat.l bank" (?) 12 USC § 221

→ search 18 USC 610 /nat.l bank / contrib

Ark Stat 23-34-107 – misappl. of funds.

~~Jodie Myers~~ FINCEN (703) 905 3520
→ Chief Counsel.
Steve Kroll → § 221

Nat.l bank – bank corp chartered by Comptroller of Currency.

Fraud – DOJ John Arterberry

code of federal regulations

Federal Elections

11

Revised as of January 1, 1995

CONTAINING
A CODIFICATION OF DOCUMENTS
OF GENERAL APPLICABILITY
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the Federal Register

pital stock, or a local, national, ternational labor organization

xpressly provides for "members" articles and by-laws;
Expressly solicits members; and
Expressly acknowledges the ac- ice of membership, such as by g a membership card or inclusion iembership newsletter list.
Members means all persons who irrently satisfying the require- for membership in a membership ation, affirmatively accept the ership association's invitation to e a member, and either:
Have some significant financial iment to the membership asso- n, such as a significant invest- or ownership stake (but *not* mere- payment of dues);
Are required to pay on a regular a specific amount of dues that is ermined by the association and titled to vote directly either for ast one member who has fully ipatory and voting rights on the t governing body of the member- ssociation, or for those who se- t least one member of those on ighest governing body of the ership association; or
Are entitled to vote directly for those on the highest governing of the membership association.
Notwithstanding the requirements agraph (e)(2)(ii) of this section, ommission may determine, on a y case basis, that persons seeking considered members of a member- ssociation for purposes of this n have a significant organiza- and financial attachment to the ation under circumstances that ; precisely meet the requirements general rule. For example, stu- nembers who pay a lower amount es while in school or long term paying members who qualify for ne membership status with little dues obligation may be consid- members if they retain voting in the association.
Notwithstanding the requirements agraphs (e)(2) (i) through (iii) of ection, members of a local union nsidered to be members of any al or international union of the local, union is a part and of

any federation with which the local, national, or a international union is affiliated.

(f) *Method of facilitating the making of contributions* means the manner in which the contributions are received or collected such as, but not limited to, payroll deduction or checkoff systems, other periodic payment plans, or return envelopes enclosed in a solicitation request.

(g) *Method of soliciting voluntary contributions* means the manner in which the solicitation is undertaken including, but not limited to, mailings, oral requests for contributions, and hand distribution of pamphlets.

(h) *Stockholder* means a person who has a vested beneficial interest in stock, has the power to direct how that stock shall be voted, if it is voting stock, and has the right to receive dividends.

(i) *Voluntary contributions* are contributions which have been obtained by the separate segregated fund of a corporation or labor organization in a manner which is in compliance with §114.5(a) and which is in accordance with other provisions of the Act.

(2 U.S.C. 431(8)(B)(iii), 432(c)(3). 438(a)(8), 441b; 2 U.S.C. 441b, 437d(a)(8))

[41 FR 35955, Aug. 25, 1976, as amended at 44 FR 63045, Nov. 1. 1979; 45 FR 15125, Mar. 7, 1980; 45 FR 21210, Apr. 1, 1980; 48 FR 50508, Nov. 2, 1983; 57 FR 1640, Jan. 15, 1992; 58 FR 45775, Aug. 30, 1993; 59 FR 33615, June 29, 1994]

§114.2 Prohibitions on contributions and expenditures.

(a) National banks, or corporations organized by authority of any law of Congress, are prohibited from making a contribution or expenditure, as defined in §114.1(a), in connection with election to any political office, including local, State and Federal offices, or in connection with any primary election or political convention or caucus held to select candidates for any political office, including any local, State or Federal office.

(1) Such national banks and corporations may engage in the activities permitted by this part, except to the extent that such activity is foreclosed by provisions of law other than the Act.

(2) The provisions of this part apply to the activities of a national bank or corporation organized by any law of Congress in connection with both State and Federal elections.

(b) Any corporation whatever or any labor organization is prohibited from making a contribution or expenditure, as defined in §114.1(a) in connection with any Federal election.

(c) A candidate, political committee, or other person is prohibited from knowingly accepting or receiving any contribution prohibited by this section.

(d) No officer or director of any corporation or any national bank, and no officer of any labor organization shall consent to any contribution or expenditure by the corporation, national bank, or labor organization prohibited by this section.

[41 FR 35955, Aug. 25, 1976]

§114.3 Disbursements for communications in connection with a Federal election to restricted class.

(a) *General.* (1) A corporation may make communications including partisan communications to its stockholders and executive or administrative personnel and their families on any subject. A labor organization may make communications including partisan communications to its members and executive or administrative personnel and their families on any subject. Corporations and labor organizations may also make the nonpartisan communications permitted under 11 CFR 114.4 to their restricted class or any part of that class. No corporation or labor organization may make contributions or expenditures for partisan communications to the general public in connection with a federal election and no national bank or corporation organized by authority of any law of Congress may make contributions or expenditures for partisan communications to the general public in connection with any election to any political office including any State or local office.

(2) An incorporated membership organization, incorporated trade association, incorporated cooperative or corporation without capital stock may communicate with its members and executive or administrative personnel, and their families, as permitted in 11 CFR 114.3 (a)(1) and (c), and shall re-

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 5

UNITED STATES CODE ANNOTATED
TITLE 2. THE CONGRESS
CHAPTER 14--FEDERAL ELECTION CAMPAIGNS
SUBCHAPTER I--DISCLOSURE OF FEDERAL CAMPAIGN FUNDS

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Current through P.L. 104-8, approved 4-17-95

§ 441b. Contributions or expenditures by national banks, corporations, or labor organizations

(a) It is unlawful for any national bank, or any corporation organized by authority of any law of Congress, to make a contribution or expenditure in connection with any election to any political office, or in connection with any primary election or political convention or caucus held to select candidates for any political office, or for any corporation whatever, or any labor organization, to make a contribution or expenditure in connection with any election at which presidential and vice presidential electors or a Senator or Representative in, or a Delegate or Resident Commissioner to, Congress are to be voted for, or in connection with any primary election or political convention or caucus held to select candidates for any of the foregoing offices, or for any candidate, political committee, or other person knowingly to accept or receive any contribution prohibited by this section, or any officer or any director of any corporation or any national bank or any officer of any labor organization to consent to any contribution or expenditure by the corporation, national bank, or labor organization, as the case may be, prohibited by this section.

(b) (1) For the purposes of this section the term "labor organization" means any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work.

(2) For purposes of this section and section 791 (h) of Title 15, the term "contribution or expenditure" shall include any direct or indirect payment, distribution, loan, advance, deposit, or gift of money, or any services, or anything of value (except a loan of money by a national or State bank made in accordance with the applicable banking laws and regulations and in the ordinary course of business) to any candidate, campaign committee, or political party or organization, in connection with any election to any of the offices referred to in this section, but shall not include (A) communications by a corporation to its stockholders and executive or administrative personnel and their families or by a labor organization to its members and their families on any subject; (B) nonpartisan registration and get-out-the-vote campaigns by a corporation aimed at its stockholders and executive or administrative personnel and their families, or by a labor organization aimed at its members and their families; and (C) the establishment, administration, and solicitation of contributions to a separate segregated fund to be utilized for political purposes by a corporation, labor organization, membership organization, cooperative, or corporation without capital stock.

(3) It shall be unlawful--

(A) for such a fund to make a contribution or expenditure by utilizing money or anything of value secured by physical force, job discrimination, financial reprisals, or the threat of force, job discrimination, or financial reprisal; or by dues, fees, or other moneys required as a condition of membership in a labor organization or as a condition of employment, or by moneys obtained in any commercial transaction;

(B) for any person soliciting an employee for a contribution to such a fund to fail to inform such employee of the political purposes of such fund at the time of such solicitation; and

(C) for any person soliciting an employee for a contribution to such a fund to fail to inform such employee, at

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the time of such solicitation, of his right to refuse to so contribute without any reprisal.

(4) (A) Except as provided in subparagraphs (B), (C), and (D), it shall be unlawful--

(i) for a corporation, or a separate segregated fund established by a corporation, to solicit contributions to such a fund from any person other than its stockholders and their families and its executive or administrative personnel and their families, and

(ii) for a labor organization, or a separate segregated fund established by a labor organization, to solicit contributions to such a fund from any person other than its members and their families.

(B) It shall not be unlawful under this section for a corporation, a labor organization, or a separate segregated fund established by such corporation or such labor organization, to make 2 written solicitations for contributions during the calendar year from any stockholder, executive or administrative personnel, or employee of a corporation or the families of such persons. A solicitation under this subparagraph may be made only by mail addressed to stockholders, executive or administrative personnel, or employees at their residence and shall be so designed that the corporation, labor organization, or separate segregated fund conducting such solicitation cannot determine who makes a contribution of $50 or less as a result of such solicitation and who does not make such a contribution.

(C) This paragraph shall not prevent a membership organization, cooperative, or corporation without capital stock, or a separate segregated fund established by a membership organization, cooperative, or corporation without capital stock, from soliciting contributions to such a fund from members of such organization, cooperative, or corporation without capital stock.

(D) This paragraph shall not prevent a trade association or a separate segregated fund established by a trade association from soliciting contributions from the stockholders and executive or administrative personnel of the member corporations of such trade association and the families of such stockholders or personnel to the extent that such solicitation of such stockholders and personnel, and their families, has been separately and specifically approved by the member corporation involved, and such member corporation does not approve any such solicitation by more than one such trade association in any calendar year.

(5) Notwithstanding any other law, any method of soliciting voluntary contributions or of facilitating the making of voluntary contributions to a separate segregated fund established by a corporation, permitted by law to corporations with regard to stockholders and executive or administrative personnel, shall also be permitted to labor organizations with regard to their members.

(6) Any corporation, including its subsidiaries, branches, divisions, and affiliates, that utilizes a method of soliciting voluntary contributions or facilitating the making of voluntary contributions, shall make available such method, on written request and at a cost sufficient only to reimburse the corporation for the expenses incurred thereby, to a labor organization representing any members working for such corporation, its subsidiaries, branches, divisions, and affiliates.

(7) For purposes of this section, the term "executive or administrative personnel" means individuals employed by a corporation who are paid on a salary, rather than hourly, basis and who have policymaking, managerial, professional, or supervisory responsibilities.

CREDIT(S)

1985 Main Volume

(Pub.L. 92-225, Title III, § 316, formerly § 321, as added Pub.L. 94-283, Title I, § 112(2), May 11, 1976, 90 Stat. 490, renumbered and amended Pub.L. 96-187, Title I, §§ 105(5), 112(d), Jan. 8, 1980, 93 Stat. 1354,

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1366.)

< General Materials (GM) - References, Annotations, or Tables >

HISTORICAL AND STATUTORY NOTES

1980 Amendment

Subsec. (b) (4) (B). Pub.L. 96-187, § 112(d), substituted "It" for "it".

Effective Date of 1980 Amendment

Amendment by Pub.L. 96-187 effective Jan. 8, 1980, see section 301(a) of Pub.L. 96-187, set out as an Effective Date of 1980 Amendment note under section 431 of this title.

Legislative History

For legislative history and purpose of Pub.L. 94-293, see 1976 U.S.Code Cong. and Adm.News, p. 929. See, also, Pub.L. 96-187, 1979 U.S.Code Cong. and Adm.News, p. 2860.

CROSS REFERENCES

Contributions by government contractors, see 2 USCA § 441c.

Name of separate segregated fund established pursuant to this section to include name of connected organization, see 2 USCA § 432.

Penalties for violation of this section, see 2 USCA § 437g.

Statement of organization of separate segregated fund, see 2 USCA § 433.

FEDERAL PRACTICE AND PROCEDURE

Applicability of ripeness doctrine to particular action, see Wright, Miller & Cooper: Jurisdiction § 3532.

CODE OF FEDERAL REGULATIONS

Contributions and expenditures, limitations and prohibitions upon, see 11 CFR 110.1 et seq.

LAW REVIEW COMMENTARIES

Austin v. Michigan Chamber of Commerce: Re-examining corporate political rights under the First Amendment. Edward G. Reitler, 11 U. Bridgeport L.Rev. 449 (1991).

Constitutional law: Campaign finance reform and the First Amendment--All the free speech money can buy. Note, 39 Okl.L.Rev. 729 (1986).

Regulating newsletters under Federal Elections Laws and the First Amendment. Martin Boles, 40 Ark.L.Rev. 79 (1987).

Sinking the think tanks upstream: The use and misuse of tax exemption law to address the use and misuse of tax-exempt organizations by politicians. Laura Brown Chisolm, 51 U.Pitt.L.Rev. 577 (1990).

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The corporate PAC: Should we PAC it in? Kenneth A. Gross, 34 Fed.B.News/ & J. 63 (Feb. 1987).

NOTES OF DECISIONS

Admissibility of evidence 38
Bill of particulars 28
Burden of proof 37
Certification of constitutional questions 18
Constitutionality 1
Construction
Construction - Generally 2 Construction - With other laws 3 Contributions or expenditures within sections 10
Damages 43
Disbarment or suspension from practice 45

Discovery and inspection 34
Double jeopardy 30
Duty of courts 8
Exhaustion of remedies 23
Expenditure defined 9
Expenditures within sections 10
Grand jury proceedings 26
Indictment 27
Injunction 44
Instructions 42
Intent 14
Intervention 29
Issues reviewable 47
Judicial elections 12
Jurisdiction 24
Justiciability 21
Limitations 31
Membership organization 11
Moot questions 41
Motion to dismiss 33
Offenses 15
Persons
Persons - Entitled to maintain action 20 Persons - Liable 16 Persons - Protected 17 Power of Congress 7
Presumptions 36
Private right of action 19
Purpose 4
Questions for jury 40
Retroactive effect 5
Ripeness doctrine 22
Rules and regulations 8a
Scope of review 46
Separate defined 9
Speedy trial 32
State elections 13
State regulation or control 6
Summary judgment 35
Venue 25
Weight and sufficiency of evidence 39

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1. Constitutionality

Section of Federal Election Campaign Act prohibiting direct expenditure of corporate funds in connection with any election violated First Amendment as applied to nonprofit corporation which published newsletter urging readers to vote "pro-life" in upcoming primary election; corporation was formed for express purpose of promoting political ideas, had no shareholders or other persons with claim on its assets or earnings, and was not established by business corporation or labor union and did not accept contributions from such entities. Federal Election Com'n v. Massachusetts Citizens for Life, Inc., Mass. 1986, 107 S.Ct. 616, 479 U.S. 238, 93 L.Ed.2d 539.

This section limiting a noncapital stock corporation to soliciting "members" to contribute to a separate and segregated political campaign fund did not violate U.S.C.A. Const.Amend. 1 and restriction was justified by governmental purpose of insuring that substantial aggregations of wealth amassed by corporations were not converted to political "war chests" which could be used to incur political debts from legislators aided by those contributions and protecting individuals who paid money for purposes other than campaign support from having that money used to support candidates whom they might oppose, notwithstanding that this section restricts solicitation of corporations without great financial resources as well as the more fortunately situated. Federal Election Com'n v. National Right to Work Committee, Dist.Col.1982, 103 S.Ct. 552, 459 U.S. 197, 74 L.Ed.2d 364, on remand 716 F.2d 1401, 230 U.S.App.D.C. 283.

This section which authorized union political action committees to solicit members but which authorized corporate committees to solicit career employees in addition to shareholders did not violate equal protection in that this section bore substantial relation to important governmental interest in applying federal election laws evenhandedly to labor unions and corporations by recognizing that executive and administrative corporate employees share with stockholders stake in corporation's well-being and by taking into account structural differences of corporations and labor unions. International Ass'n of Machinists and Aerospace Workers v. Federal Election Commission, 1982, 678 F.2d 1092, 220 U.S.App.D.C. 45, affirmed 103 S.Ct. 335, 459 U.S. 983, 74 L.Ed.2d 379.

Person subject to Commission subpoena for investigation of allegations that national bank made loans, or permitted overdrafts, in connection with election and out of ordinary course of business would be allowed to attack constitutionality of provision of this section barring such contributions only insofar as this chapter prohibited such loans and overdrafts and would not be allowed to apply overbreadth doctrine to attack the rest of this chapter. Federal Election Commission v. Lance, C.A.Ga.1981, 635 F.2d 1132, appeal dismissed, certiorari denied 101 S.Ct. 3151, 453 U.S. 917, 69 L.Ed.2d 999.

Provision of subsec. (b) (4) (D) of this section permitting trade association or its segregated political fund to solicit contributions from stockholders and executives and administrative personnel of its member corporations and their families provided that the solicitation has been approved by member corporation and member corporation has not approved solicitation by any other trade association for the same calendar year did not deprive trade associations and political action committees of liberty without due process. Bread Political Action Committee v. Federal Election Commission, C.A.Ill.1980, 635 F.2d 621, reversed on other grounds 102 S.Ct. 1235, 455 U.S. 577, 71 L.Ed.2d 432, on remand 678 F.2d 46.

This section did not violate U.S.C.A. Const. Amends. 1, 5, or 9. Republican Nat. Committee v. Federal Election Commission, C.A.N.Y.1980, 616 F.2d 1, affirmed 100 S.Ct. 1639, 445 U.S. 955, 64 L.Ed.2d 231.

Provision of subsec. (b) (4) of this section restricting solicitation by nonstock corporations to members was not overbroad and did not infringe nonstock corporation's rights of free speech or association, inasmuch as government had a compelling interest in protecting integrity of federal elections justifying such limitation. Federal Election Commission v. National Right to Work Committee, D.C.D.C.1980, 501 F.Supp. 422, reversed 665 F.2d 371, 214 U.S.App.D.C. 215, reversed 103 S.Ct. 552.

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2. Construction

Strict standards of definiteness had to be applied to former section 610 of Title 18 because the free dissemination of ideas might be inhibited thereunder. U.S. v. Chestnut, D.C.N.Y.1975, 394 F.Supp. 581.

If a strict construction was to be given to former section 610 of Title 18 making it unlawful for labor organization to make contribution or expenditure in connection with certain elections, it was not the degree of activity but the type of activity which would determine whether or not an expenditure had been made. U.S. v. Construction & General Laborers Local Union No. 264, D.C.Mo.1951, 101 F.Supp. 869.

3. Construction with other laws

Union member's claim for future injunctive relief under section 501 of Title 29 governing fiduciary responsibility of union officers was subject to the primary jurisdiction of the Federal Election Commission insofar as it was premised on former section 610 of Title 18, now this section. Gabauer v. Woodcock, C.A.Mo.1979, 594 F.2d 662, certiorari denied 100 S.Ct. 80, 444 U.S. 841, 62 L.Ed.2d 52.

Violation of former section 610 of Title 18 pertaining to political contributions by national banks was not a lesser included offense of a violation of section 656 of Title 18 pertaining to the willful misapplication of funds by a national bank officer. U.S. v. Barket, C.A.Mo.1975, 530 F.2d 181, certiorari denied 97 S.Ct. 308, 429 U.S. 917, 50 L.Ed.2d 282.

Former section 610 of Title 18, which prohibited corporate expenditures in campaigns for federal office and which stated that phrase "contribution or expenditure" should include any direct or indirect payment to any candidate, campaign committee, or political party or organization, supplemented rather than replaced the definition of section 591 of Title 18 of prohibited expenditures to require a partisan purpose. Ash v. Cort, C.A.Pa.1974, 496 F.2d 416, reversed on other grounds 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

Section 501 of Title 29 which prohibits unlawful conversion of union funds did not duplicate former section 610 of Title 18 prohibiting contribution of labor union funds to the campaign of candidates for federal office with respect to campaign contributions as section 501 of Title 29 punishes union officers who "consent to" political contributions while former section 610 of Title 18 punished an officer who "abstracts or converts" union funds to use in federal political campaign. U.S. v. Boyle, 1973, 482 F.2d 755, 157 U.S.App.D.C. 166, certiorari denied 94 S.Ct. 593, 414 U.S. 1076, 38 L.Ed.2d 483.

4. Purpose

The evil at which Congress had struck in former section 610 of Title 18 was use of corporate or union funds to influence public at large (as distinguished, for instance, from union membership) to vote for particular candidate or particular party. U.S. v. International Union United Auto., Aircraft and Agr. Implement Workers of America (UAW-CIO), Mich.1957, 77 S.Ct. 529, 352 U.S. 567, 1 L.Ed.2d 563, rehearing denied 77 S.Ct. 808, 353 U.S. 943, 1 L.Ed.2d 763.

Intent of former section 610 of Title 18 was to permit expenditures from separate, segregated funds if the contributions to it were voluntary and to prohibit expenditures from a union's general treasury. U.S. v. Boyle, 1973, 482 F.2d 755, 157 U.S.App.D.C. 166, certiorari denied 94 S.Ct. 593, 414 U.S. 1076, 38 L.Ed.2d 483.

Under former section 610 of Title 18 prohibiting any corporation or labor organization from making a contribution or expenditure in connection with any election for federal office, Congress intended to insure against officers proceeding in such matters without obtaining the consent of shareholders by forbidding all such expenditures. U.S. v. Lewis Food Co., C.A.Cal.1966, 366 F.2d 710.

Given the nature of free speech, the absolute prohibition of corporate contributions, as enunciated in former

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section 610 of Title 18, constitutes the least drastic means to achieve the congressional goal of protecting the integrity of the political process. Federal Election Commission v. Weinsten, D.C.N.Y.1978, 462 F.Supp. 243.

Interests reflected in former section 610 of Title 18 were to destroy the influence over elections which corporations exercised through financial contributions and to prevent corporate officers from using corporate funds for contributions to political parties without the consent of the stockholders. Miller v. American Tel. & Tel. Co., D.C.Pa.1975, 394 F.Supp. 58, affirmed 530 F.2d 964.

Purpose of former section 610 of Title 18, which proscribed any expenditure or contribution by a corporation or labor organization to a candidate, campaign committee, political party or organization in connection with any federal election, was to assure a popularly elected government for all the people in the United States and its main concern was to eliminate the effect of aggregated wealth on federal elections. Ash v. Cort, D.C.Pa.1972, 350 F.Supp. 227, affirmed 471 F.2d 811.

Purpose of former section 610 of Title 18 prohibiting labor unions from making political contributions was to prevent corruptive influences on elective process and to prevent use of general union funds to support ideas and candidates opposed by even slightest minority of union membership. U.S. v. Boyle, D.C.D.C.1972, 338 F.Supp. 1028.

Goals of regulating campaign financing in accordance with due process should be to promote an informed electorate, to insure that elected officials are responsive to needs of majority who elected them and, as far as possible, to prevent elected office from becoming exclusive prize of influential or rich. U.S. v. First Nat. Bank of Cincinnati, D.C.Ohio 1971, 329 F.Supp. 1251.

Purpose of former section 610 of Title 18 prohibiting corporations and labor unions from making political contributions was to prevent corporations and labor unions from controlling elections, and to protect union members from having union officials endorse candidates or attempt to influence voters which might be contrary to wishes of individual members. U.S. v. Anchorage Central Labor Council, D.C.Alaska 1961, 193 F.Supp. 504.

In enacting former section 610 of Title 18 making it unlawful for labor organization to make contribution or expenditure in connection with certain elections, Congress did not intend that an uncertain, insignificant amount should be considered as an expenditure and used as a basis for a criminal prosecution, and did not intend to deprive labor organization from making expenditures, if necessary, in connection with registration of voters. U.S. v. Construction & General Laborers Local Union No. 264, D.C.Mo.1951, 101 F.Supp. 869.

5. Retroactive effect

Even if provision of former section 610 of Title 18 prohibiting financing of establishment administration, and solicitation of contributions for voluntary political funds from general union monies was impliedly repealed by 1972 amendment, prosecution begun before amendment would not abate in view of section 109 of Title 1. Pipefitters Local Union No. 562 v. U.S., Mo.1972, 92 S.Ct. 2247, 407 U.S. 385, 33 L.Ed.2d 11.

Federal Election Commission's enforcement powers are not prospective only, but are retroactively applicable. Federal Election Commission v. Lance, C.A.Ga.1980, 617 F.2d 365, supplemented 635 F.2d 1132, appeal dismissed, certiorari denied 101 S.Ct. 3151, 453 U.S. 917, 69 L.Ed.2d 999.

The insertion in former section 610 of Title 18 of definition of the phrase "contribution or expenditure" to supplement definitions of "contribution" and "expenditure" did not make illegal conduct which had prior to 1972 amendments been legal. U.S. v. Chestnut, D.C.N.Y.1975, 394 F.Supp. 581.

6. State regulation or control

West's RCWA 41.04.230 which did not authorize state budget director to permit voluntary payroll deductions

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for employees for purpose of making direct contribution to political action committee of employees' labor associations was not in conflict with and therefore preempted by provisions of this chapter as this chapter affected federal elections only and as there was nothing in this chapter that required employer to establish payroll deduction plan for its own employees. Washington Ed. Ass'n v. Smith, 1981, 638 P.2d 77, 96 Wash.2d 601.

7. Power of Congress

Congress may legitimately regulate federal campaign financing. U.S. v. Boyle, 1973, 482 F.2d 755, 157 U.S.App.D.C. 166, certiorari denied 94 S.Ct. 593, 414 U.S. 1076, 38 L.Ed.2d 483.

Congress has constitutional power to prohibit contributions to be made by certain corporations in connection with any election at which, among others, representatives in Congress are to be voted for. U.S. v. Brewers' Ass'n, D.C.Pa.1916, 239 F. 163.

8. Duty of courts

Judiciary will not second guess a legislative determination as to need for prophylactic measures where corruption of election process is the evil feared and differing structures and purposes of different entities may require different forms of regulation of campaign financing in order to protect integrity of the electoral process. Federal Election Com'n v. National Right to Work Committee, Dist.Col.1982, 103 S.Ct. 552, 459 U.S. 197, 74 L.Ed.2d 364, on remand 716 F.2d 1401, 230 U.S.App.D.C. 283.

8A. Rules and regulations

Regulation of the Federal Election Commission (FEC) permitting corporations to prepare and distribute voter guides only if they are nonpartisan and do not engage in issue advocacy did not fall within statutory authority of section of the Federal Election Campaign Act (FECA) prohibiting corporations from using general treasury funds to make contributions or expenditures in connection with any federal election, as statute only prohibits an expenditure which constitutes "express advocacy." Faucher v. Federal Election Com'n, C.A.1 (Me.) 1991, 928 F.2d 468, certiorari denied 112 S.Ct. 79, 502 U.S. 820, 116 L.Ed.2d 52 .

Federal Election Commission (FEC) regulation prohibiting corporations from making any expenditures to publish voter guides went beyond FEC's power by focusing on issue advocacy; only express advocacy for election or defeat of identifiable candidate or candidates would be constitutionally within statutory prohibition against corporate expenditures to select candidates. Faucher v. Federal Election Com'n, D.Me.1990, 743 F.Supp. 64, affirmed 928 F.2d 468, certiorari denied 112 S.Ct. 79, 116 L.Ed.2d 52.

9. Separate and expenditure defined

Term "separate" in 1972 amendment of former section 610 of Title 18 relating to political contributions by corporations and unions was synonymous with "segregated"; term "threat" included creation of appearance of intent to inflict injury even without design to carry it out; and "dues, fees, or other monies required as a condition of membership in a labor organization or as a condition of employment" included contributions effectively assessed even if not actually required for employment or union membership. Pipefitters Local Union No. 562 v. U.S., Mo.1972, 92 S.Ct. 2247, 407 U.S. 385, 33 L.Ed.2d 11.

"Expenditure" within provision of former section 251 of this title prohibiting election contributions and expenditures was not a word of art, had no definitely defined meaning and applicability of word to prohibition of particular acts had to be determined from circumstances surrounding its employment. U.S. v. Congress of Industrial Organizations, 1948, 68 S.Ct. 1349, 335 U.S. 106, 92 L.Ed. 1849.

10. Contribution or expenditures within section

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Nonprofit corporation's regular publication of newsletter did not entitle it to press exemption under Federal Election Campaign Act for its publication of "special edition" which urged readers to vote "pro-life" in upcoming primary election; "special edition" was not published through facilities of regular newsletter, was distributed to group 20 times size of newsletter's normal audience, and did not contain volume and issue number identifying it as one in continuing series of issues. Federal Election Com'n v. Massachusetts Citizens for Life, Inc., Mass. 1986, 107 S.Ct. 616, 479 U.S. 238, 93 L.Ed.2d 539.

1972 amendment to former section 610 of Title 18 relating to political contributions by corporations and unions permitted union officials to establish, administer, and solicit contributions for political fund, provided fund was separate and segregated and that contributions and expenditures not be financed through physical force, job discrimination, or financial reprisal or threat thereof, or through dues, fees, or other monies required as condition of membership in labor organization or as condition of employment. Pipefitters Local Union No. 562 v. U.S., Mo.1972, 92 S.Ct. 2247, 407 U.S. 385, 33 L.Ed.2d 11.

Corporation's multicandidate political action committee made expenditures for "political purposes" and complied with Federal Election Campaign Act when it contributed to candidates facing weak or absent opposition, contributed without regard to candidates' attitudes towards business, contributed to opposing candidates, contributed to election winners, and supported incumbents. Stern v. Federal Election Com'n, C.A.D.C.1990, 921 F.2d 296.

Determination of Federal Election Commission that senior citizens' picnic sponsored by congressman was nonpolitical event, so that corporate donations to event were not illegal, was not arbitrary or capricious in view of fact that no campaign contributions were solicited or accepted at event and that literature was not distributed. Orloski v. Federal Election Com'n, 1986, 795 F.2d 156, 254 U.S.App.D.C. 111.

Reverse checkoff procedure used in conjunction with payroll deduction plan to obtain contributions to political action committee established by State Education Association amply protected rights of dissenters and met jurisprudence test of voluntariness of contributions where membership in Association was not prerequisite to employment in public education system, Association member could check off to indicate that he or she did not agree to make contribution or could ask for refund of contribution and nothing in record indicated that dissenting Association members were subject to any recriminations within Association. Kentucky Educators Public Affairs Council v. Kentucky Registry of Election Finance, C.A.Ky.1982, 677 F.2d 1125.

Under this chapter, no part of monies of a union's segregated political fund should be comingled with regular dues money, even temporarily. American Federation of Labor and Congress of Indus. Organizations (AFL-CIO) v. Federal Election Commission, 1980, 628 F.2d 97, 202 U.S.App.D.C. 97, certiorari denied 101 S.Ct. 397, 449 U.S. 982, 66 L.Ed.2d 244.

The expenditure by a small labor organization of $111.14 to pay cost of political advertisement in daily newspaper of general circulation and of $32.50 to pay cost of political radio broadcast over commercial radio station advocating rejection of a candidate for Republican nomination for President and his defeat in Presidential election if nominated and rejection of six incumbent Congressmen as candidates for reelection and their defeat in Congressional election if nominated did not violate former section 610 of Title 18. U.S. v. Painters Local Union No. 481, C.A.Conn.1949, 172 F.2d 854.

Payment by corporation to associated political campaign fund was not reimbursement of solicitation expenses but rather was illegal contribution in violation of Federal Election Campaign Act where reimbursement was made more than 30 days after solicitation expenses were incurred, even though corporation claimed it had simply changed its mind and for fiscal reasons wanted to have campaign fund bear cost of solicitation as it originally had; motivation for making payment could not render payment lawful where it was untimely. Federal Election Com'n v. NRA Political Victory Fund, D.D.C.1991, 778 F.Supp. 62.

Membership solicitation letters mailed by women's rights group on issues of pay inequality, abortion, and equal

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rights did not represent express advocacy of election of particular candidates, and use of corporate funds in connection with those mailings thus did not violate Federal Election Campaign Act; letters could be regarded as discussions of public issues that by their nature invoked the names of certain politicians and did not provide explicit directives to vote against those politicians. Federal Election Com'n v. National Organization for Women, D.D.C.1989, 713 F.Supp. 428.

Essence of whether contribution to political fund is actually or effectively required for union membership in violation of this chapter is whether method of solicitation for fund is calculated to result in knowing free-choice donations; "knowing free-choice" donation means act intentionally taken and not the result of inaction when confronted with an obstacle. Federal Election Commission v. National Ed. Ass'n, D.C.D.C.1978, 457 F.Supp. 1102.

A corporation's payment to Senator's advertising firm of $12,000 for one month's services to Senator's campaign constituted a "contribution" to Senator's campaign notwithstanding contention that the term "contribution" as defined in former section 610 of Title 18 did not include the term "payment". U.S. v. Chestnut, D.C.N.Y.1975, 394 F.Supp. 581.

Labor unions' contributions or expenditures of money in connection with political campaigns must be from voluntarily financed segregated union funds. Evans v. American Federation of Television and Radio Artists, D.C.N.Y.1973, 354 F.Supp. 823, reversed on other grounds 496 F.2d 305, certiorari denied 95 S.Ct. 688, 419 U.S. 1093, 42 L.Ed.2d 687, rehearing denied 95 S.Ct. 1342.

Where corporation expended its general funds to pay for advertisement to communicate to public its views as to honest campaigns and elections, and its views as to a statement made by an unnamed candidate for election aimed at community of which it was a part, without advocating election of any particular person or party, payment for advertisement did not constitute an "expenditure" within former section 610 of Title 18 proscribing any expenditure or contribution by a corporation or labor organization to a candidate, campaign committee, political party or organization in connection with any federal election. Ash v. Cort, D.C.Pa.1972, 350 F.Supp. 227, affirmed, 471 F.2d 811.

Although former section 610 of Title 18 prohibiting labor unions from making political contributions did not expressly preclude indirect contributions from general funds of union, legislative history of said section clearly indicated that Congress wished to prohibit any type of use of general union funds for designated purposes of said section, and this would include both a direct and/or an indirect contribution or expenditure. U.S. v. Boyle, D.C.D.C.1972, 338 F.Supp. 1028.

Expenditures do not violate prohibition on corporate campaign contribution if officers of corporation do not use corporation's funds to endorse candidates or attempt to influence voters which may be contrary to wishes of individual stockholder or if funds used are not general funds but funds voluntarily provided by stockholders or are general funds so used with consent of stockholders. U.S. v. Lewis Food Co., D.C.Cal.1964, 236 F.Supp. 849.

Labor union's payments to three employees, two of whom were regularly on payroll of union, one for a long period of time, and who devoted a considerable portion of their time to political activities, some of which activities, such as registration of voters and taking voters to polls, were for general benefit of those who were candidates and some of which were devoted exclusively to political interests of one candidate for Congress were not "expenditures" and "contributions" within former section 610 of Title 18 making it unlawful for labor organization to make "expenditure" or "contribution" in connection with certain elections. U.S. v. Construction & General Laborers Local Union No. 264, D.C.Mo.1951, 101 F.Supp. 869.

11. Membership organization

The 267,000 individuals solicited by nonprofit, noncapital stock corporation to contribute to corporation's segregated political campaign fund were not "members" within meaning of this section where, although

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membership cards were sent to those who either contributed or responded to questionaire, the solicitation letters made no reference to members, members played no part in operation or administration of the corporation, there was no indication that the asserted members exercised control over expenditure of their contributions and articles of incorporation and other publicly filed documents explicitly disclaimed existence of members. Federal Election Com'n v. National Right to Work Committee, Dist.Col.1982, 103 S.Ct. 552, 459 U.S. 197, 74 L.Ed.2d 364, on remand 716 F.2d 1401, 230 U.S.App.D.C. 283.

The term "members" in subsec. (b) (4) (C) of this section, creating exception to subsec. (b) (4) (A) of this section, declaring it unlawful for a corporation, or separate segregated fund established by corporation, to solicit contributions to such a fund from any person other than its shareholders and their families and its executives or other administrative personnel and their families, necessarily includes those individuals solicited by the National Right to Work Committee, a nonprofit corporation without capital stock that was formed to educate the public on and to advocate volunteer unionism. National Right to Work Committee, Inc. v. Federal Election Commission, 1981, 665 F.2d 371, 214 U.S.App.D.C. 215, reversed 103 S.Ct. 552, 459 U.S. 197, 74 L.Ed.2d 364, on remand 716 F.2d 1401, 230 U.S.App.D.C. 283.

State medical association was not embraced by phrase "membership organizations" in subsec. (b) (2) (c) of this section so as to fall within exemption for unlimited administrative support, the "membership organizations" language being only intended to rescue organizations that would otherwise fall within blanket prohibition of any election activity. California Medical Ass'n v. Federal Election Commission, C.A.Cal.1980, 641 F.2d 619, affirmed 101 S.Ct. 2712, 453 U.S. 182, 69 L.Ed.2d 567.

As used in membership exception to general prohibition of this section against corporate and union spending in connection with federal elections, allowing membership organizations, cooperatives, and corporations without capital stock to solicit their members, term "member" encompasses persons who have interests and rights in an organization similar to those of a shareholder in a corporation and a union member in a labor organization and the term at least denotes a formal relationship in which a person, whether specifically described as a member or not, has specified rights and obligations vis-a-vis an organization. Federal Election Commission v. National Right to Work Committee, D.C.D.C.1980, 501 F.Supp. 422, reversed 665 F.2d 371, 214 U.S.App.D.C. 215, reversed 103 S.Ct. 552, 459 U.S. 197, 74 L.Ed.2d 364, on remand 716 F.2d 1401, 230 U.S.App.D.C. 283.

12. Judicial elections

Former section 610 of Title 18 making it unlawful for any national bank to make a contribution in connection with any election to any political office was applicable to contributions to judicial elections. U.S. v. Clifford, D.C.N.Y.1976, 409 F.Supp. 1070.

13. State elections

If state law permits corporation to use corporate funds as contributions in state elections, shareholders are on notice that the funds may be so used and have no recourse under any federal provision. Cort v. Ash, Pa.1975, 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

Former section 610 of Title 18 making it unlawful for any national bank to make a contribution in connection with any election to any political office was applicable to state elections. U.S. v. Clifford, D.C.N.Y.1976, 409 F.Supp. 1070.

Assessment by local union of radio artists to oppose initiative measure appearing on ballot in state election did not violate former section 251 of this title, since such section could not interfere with state elections. De Mille v. American Federation of Radio Artists, Los Angeles Local, Cal.App.1946, 175 P.2d 851.

14. Intent

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To prove a violation of former section 610 of Title 18 prohibiting political campaign contributions by national banks in making postelection contributions, there had to be proof of an intent to influence the election. U.S. v. Clifford, D.C.N.Y.1976, 409 F.Supp. 1070.

15. Offenses

Nonprofit corporation's publication and distribution of newsletter urging readers to vote "pro-life" in upcoming primary election was "express advocacy" subject to Federal Election Campaign Act's prohibition of direct expenditure of corporate funds in connection with any election; newsletter identified and provided photographs of specific "pro-life" candidates. Federal Election Com'n v. Massachusetts Citizens for Life, Inc., Mass. 1986, 107 S.Ct. 616, 479 U.S. 238, 93 L.Ed.2d 539.

Labor organization's use of union dues to sponsor commercial television broadcast designed to influence election to select certain candidates for Congress would be violative of former section 610 of Title 18. U.S. v. International Union United Auto, Aircraft and Agr. Implement Workers of America (UAW-CIO), Mich.1957, 77 S.Ct. 529, 352 U.S. 567, 1 L.Ed.2d 563, rehearing denied 77 S.Ct. 808, 353 U.S. 943, 1 L.Ed.2d 763.

Provision of former section 251 of this title making it unlawful for any corporation or labor organization to make a contribution or expenditure in connection with certain elections did not forbid publication, by corporations and unions, in regular course of conducting their affairs, of trade or union periodicals published regularly for members, stockholders or customers, expressing views on candidates or proposed measures in regular course of publication. U.S. v. Congress of Industrial Organizations, 1948, 68 S.Ct. 1349, 335 U.S. 106, 92 L.Ed. 1849.

Under section of the Federal Election Campaign Act (FECA) prohibiting corporations from using general treasury funds to make contributions or expenditures in connection with any federal election, the Federal Election Commission (FEC) does not have the authority to restrict issue advocacy; rather, the FEC may only restrict express advocacy. Faucher v. Federal Election Com'n, C.A.1 (Me.) 1991, 928 F.2d 468, certiorari denied 112 S.Ct. 79, 116 L.Ed.2d 52.

Though certain solicitations by nonprofit, noncapital stock corporation of persons for contributions to separate segregated political fund that it sponsored violated restrictions of this chapter on contributions or expenditures by corporations in connection with federal elections, those violations were not made in "defiance" or "knowing, conscious, and deliberate flaunting" of this chapter so as to warrant penalty assessment and requirement of refund by the corporation of funds solicited. National Right to Work Committee, Inc. v. Federal Election Com'n, 1983, 716 F.2d 1401, 230 U.S.App.D.C. 283.

Mere failure of corporation to collect debt owed by a national committee of political party for communication services provided by corporation at party convention would not violate prohibition of former section 610 of Title 18 against corporate campaign spending. Miller v. American Tel. & Tel. Co., C.A.Pa.1974, 507 F.2d 759, on remand 394 F.Supp. 58.

Fact that no candidate or party was named in corporation's ad and pamphlet did not place them outside scope of prohibition of former section 610 of Title 18 against corporate expenditures in campaigns for federal office. Ash v. Cort, C.A.Pa.1974, 496 F.2d 416, reversed on other grounds 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

Essential elements constituting violation of former section 610 of Title 18 prohibiting labor organizations from making contributions and expenditures to candidates for federal offices were (1) contribution or expenditure, (2) by a labor organization, (3) for purpose of active electioneering (4) in connection with an election for named federal offices. U.S. v. Pipefitters Local Union No. 562, C.A.Mo.1970, 434 F.2d 1116, adhered to 434 F.2d 1127, reversed in part, vacated in part on other grounds 92 S.Ct. 2247, 407 U.S. 385, 33 L.Ed.2d 11.

Where all members of labor organization having same pay scale paid same dues and political fund was established by members authorizing allocations from their dues to the fund, expenditures out of fund for political

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purposes would violate former section 610 of Title 18 prohibiting utilization, for political purposes, of moneys secured by dues required as condition of membership in union. Barber v. Gibbons, D.C.Mo.1973, 367 F.Supp. 1102.

Corporation's advertisements employing rating system to show percentage of each incumbent officer's "votes cast in favor of constitutional principles" did not violate prohibition of former section 610 of Title 18 on corporate campaign contributions. U.S. v. Lewis Food Co., D.C.Cal.1964, 236 F.Supp. 849.

16. Persons liable

Indictment and conviction of labor union was not a condition precedent to indictment and conviction of its officers under former section 610 of Title 18 prohibiting labor unions from making political contributions, and indictment against individual defendants charging conspiratorial and substantive violations of said section was not defective by reason of fact that labor union had not previously been indicted and convicted. U.S. v. Boyle, D.C.D.C.1972, 338 F.Supp. 1028.

17. Persons protected

Former section 610 of Title 18 was primarily concerned with corporations as a source of aggregated wealth and therefore of possible corrupting influence, and protection of ordinary stockholders was at best a secondary concern. Cort v. Ash, Pa.1975, 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

Shareholders are within class for whose protection prohibition of former section 610 of Title 18 against corporate political contributions was enacted. Miller v. American Tel. & Tel. Co., C.A.Pa.1974, 507 F.2d 759, on remand 394 F.Supp. 58.

18. Certification of constitutional questions

While there exists a serious question concerning the constitutionality under U.S.C.A. Const. Amend. 1 of the Federal Corrupt Practices Act, former section 241 et seq. of this title, the instant panel did not have jurisdiction to resolve that issue but was obliged, under section 437h(a) of this title, to "* * * certify all questions of constitutionality of this Act [this chapter] to the United States court of appeals for the circuit involved, which shall hear the matter sitting en banc". Federal Election Commission v. Lance, C.A.Ga.1980, 617 F.2d 365, supplemented 635 F.2d 1132, appeal dismissed, certiorari denied 101 S.Ct. 3151, 453 U.S. 917, 69 L.Ed.2d 999.

19. Private right of action

Private cause of action by stockholder to secure derivative damage relief was not available under former section 610 of Title 18, but rather was available, if at all, under state law governing corporations. Cort v. Ash, Pa.1975, 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

Stockholders did not have private right of action against corporate directors to recover direct damages for alleged violations by the directors of former section 610 of Title 18. Miller v. American Tel. & Tel. Co., D.C.Pa.1975, 394 F.Supp. 58, affirmed 530 F.2d 964.

Former section 610 of Title 18 relating to political contributions by labor union did not authorize private right of action. McNamara v. Johnston, D.C.Ill.1973, 360 F.Supp. 517, certiorari denied 96 S.Ct. 1506, 425 U.S. 911, 47 L.Ed.2d 761, affirmed 522 F.2d 1157.

Penal sanctions provided for in former section 610 of Title 18, which proscribed any expenditure or contribution by a corporation or labor organization to a candidate, campaign committee, political party or organization in connection with any federal election, were exclusive, and no private cause of action was implied.

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Ash v. Cort, D.C.Pa.1972, 350 F.Supp. 227, affirmed 471 F.2d 811.

20. Persons entitled to maintain action

Individual union members, who alleged that they suffered relative diminution in their political voices as direct result of discriminatory imbalance alleged to have resulted from enactment of this section which would likely be redressed by declaring this section unconstitutional, and individual stockholders, who alleged that use of corporate assets to establish and support corporate political action committees impinged upon their constitutional freedoms and would be eliminated by declaring this section unconstitutional, had standing to raise their U.S.C.A. Const.Amends. 1 and 5 challenges to this section. International Ass'n of Machinists and Aerospace Workers v. Federal Election Commission, 1982, 678 F.2d 1092, 220 U.S.App.D.C. 45, affirmed 103 S.Ct. 335, 459 U.S. 983, 74 L.Ed.2d 379.

Plaintiff, who alleged, economic injury as a stockholder whose interest in corporation was worth less than it would be had defendant directors not caused challenged expenditures to be made, and further injury as a citizen and voter whose ability to secure a responsive federal government had been lessened, had standing to maintain action for an injunction and damages based on alleged violation of prohibition of former section 610 of Title 18 against corporate expenditures in campaigns for federal office. Ash v. Cort, C.A.Pa.1974, 496 F.2d 416, reversed on other grounds 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

Nonprofit membership corporation that accepted contributions from business corporations did not have standing to challenge Federal Election Campaign Act section that prohibited express advocacy by corporation for election or defeat of identifiable candidates; without explicit policy against contributions from corporations, risk would remain that nonprofit corporation would serve as conduit for direct spending by corporations. Faucher v. Federal Election Com'n, D.Me.1990, 743 F.Supp. 64, affirmed 928 F.2d 468, certiorari denied 112 S.Ct. 79, 502 U.S. 820, 116 L.Ed.2d 52.

21. Justiciability

Actions for declaratory and injunctive relief alleging that this chapter violated rights guaranteed by U.S.C.A. Const.Amends. 1 and 5 by restricting solicitation of contributions to, and by, certain corporate and trade association political action committees or separate segregated funds, were nonjusticiable as a constitutional matter and inappropriate for adjudication as a prudential matter and, hence, were properly dismissed where, there was no enforcement threat or even certainty that parties would ever be at odds about interpretation of restriction where prohibition against solicitation activities, advisory opinions could be obtained from the Federal Election Commission and where there was no urgency of decision that outweighed the inadvisability of premature constitutional adjudication. Martin Tractor Co. v. Federal Election Commission, 1980, 627 F.2d 375, 200 U.S.App.D.C. 322, certiorari denied 101 S.Ct. 360, 449 U.S. 954, 66 L.Ed.2d 218.

Even if stockholders, who brought action against directors of corporation based on violations of prohibition of former section 610 of Title 18 against corporate expenditures in campaigns for federal office, had no live claim for injunctive relief after election, the dispute over damages rendered controversy justiciable. Ash v. Cort, C.A.Pa.1974, 496 F.2d 416, reversed on other grounds 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

22. Ripeness doctrine

Challenge to constitutionality of provision of this section on ground that it violated ex post facto clause was not ripe for review where it was not clear that no violations of this chapter in fact occurred after its enactment and it was not clear that criminal penalties would be sought against complainant. Federal Election Commission v. Lance, C.A.Ga.1981, 635 F.2d 1132, appeal dismissed, certiorari denied 101 S.Ct. 3151, 453 U.S. 917, 67 L.Ed.2d 999.

Action seeking declaratory judgment that committee on political education could make in-kind contributions to

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federal candidates using goods and services purchased at fair market value from organization with payments made in advance or within commercially reasonable period of time was not ripe for adjudication where Federal Election Commission had not been given opportunity to reconsider its decision that contributions amounted to illegal corporate contributions. Sierra Club v. Federal Election Com'n, D.C.D.C.1984, 593 F.Supp. 166.

23. Exhaustion of remedies

Citizen of stockholder objecting to alleged violations in future elections of former section 610 of Title 18 had to pursue statutory remedy of a complaint to the Federal Election Commission, under section 437d of this title, and invoke its authority to request the Attorney General to seek injunctive relief. Cort v. Ash, Pa.1975, 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

Action seeking declaratory judgment that committee on political education could make in-kind contributions to federal candidates using goods and services purchased at fair market value from organization with payments made in advance or within commercially reasonable period of time was barred by plaintiffs' failure to exhaust administrative remedies where plaintiffs did not seek reconsideration of Federal Elections Commission advisory opinion finding that methods proposed by plaintiffs would constitute illegal corporate contribution or demonstrate that reconsideration would be futile. Sierra Club v. Federal Election Com'n, D.C.D.C.1984, 593 F.Supp. 166.

24. Jurisdiction

Statutory remedy before Federal Election Commission was intended to govern all allegations of improper contributions in federal elections and the federal courts did not have jurisdiction of action by local union members to enjoin union officers from making contributions in alleged violation of former section 610 of Title 18. McNamara v. Johnston, C.A.Ill.1975, 522 F.2d 1157, certiorari denied 96 S.Ct. 1506, 425 U.S. 911, 47 L.Ed.2d 761.

United States district court had no jurisdiction to review executive decision to bring indictment against individual defendant charging violation of former section 610 of Title 18 prohibiting labor unions from making political contributions, but district court would decline jurisdiction even if it was present, where exercising jurisdiction would not only frustrate will of Congress in enacting said section but would also open up a Pandora's box in connection with administration of justice and proper enforcement of criminal laws. U.S. v. Boyle, D.C.D.C.1971, 338 F.Supp. 1025, motion denied 331 F.Supp. 1181.

25. Venue

In prosecution for knowingly causing another to accept or receive an illegal corporate campaign contribution, venue was proper in Southern District of New York, where recipient of check for illegal contribution deposited check in bank in that District, notwithstanding contention that venue was improper in that District because all defendant's conduct in causing acceptance or receipt of contribution was performed by him in Minnesota. U.S. v. Chestnut, D.C.N.Y.1975, 399 F.Supp. 1292, affirmed 533 F.2d 40, certiorari denied 97 S.Ct. 88, 429 U.S. 829, 50 L.Ed.2d 93.

26. Grand jury proceedings

Indictment charging substantive and conspiratorial violations of former section 610 of Title 18 prohibiting labor union from making political contributions was not subject to dismissal on ground of presence of an unauthorized person in grand jury room, where neither in memorandum of points and authorities in support of motion to dismiss nor at hearing on motion was any evidence produced substantiating claim. U.S. v. Boyle, D.C.D.C.1972, 338 F.Supp. 1028.

27. Indictment

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Indictment alleging contribution or expenditure from general treasury of union or corporation in connection with federal election states offense. Pipefitters Local Union No. 562 v. U.S., Mo.1972, 92 S.Ct. 2247, 407 U.S. 385, 33 L.Ed.2d 11.

Indictment charging publication by labor union with union funds of weekly periodical which, in issue of certain date contained statement by union president urging that union members vote for certain candidate for Congress, and charging distribution of the particular issue in regular course to those accustomed to receive copies of the periodical, did not allege a violation of former section 251 of this title. U.S. v. Congress of Industrial Organizations, 1948, 68 S.Ct. 1349, 335 U.S. 106, 92 L.Ed. 1849.

Failure of indictment charging violation of former section 610 of Title 18 prohibiting labor organizations from making contributions and expenditures to candidates for federal offices to allege that payments to political and education fund established by labor union were involuntary was not fatal, since voluntariness would not be controlling on proof of gist of indictment that money in fund was in truth and in fact money belonging to labor union; however, issue of voluntariness, along with intention of donors as to ownership and control of fund, was relevant and material on issue of whether fund was property of union. U.S. v. Pipefitters Local Union No. 562, C.A.Mo.1970, 434 F.2d 1116, adhered to 434 F.2d 1127, reversed in part, vacated in part on other grounds 92 S.Ct. 2247, 407 U.S. 385, 33 L.Ed.2d 11.

Allegation in indictment that corporation made an "expenditure" in connection with election necessarily inferred an allegation that general corporate funds were used, and, entry of plea of not guilty, gave rise to question of fact as to source of corporate funds. U.S. v. Lewis Food Co., C.A.Cal.1966, 366 F.2d 710.

An indictment against corporations for conspiracy to make unlawful campaign contributions, need not allege that offense with the particularity of an indictment directly charging it as an offense. U.S. v. U.S. Brewers' Ass'n, D.C.Pa.1916, 239 F. 163.

Indictment which alleged that United States Senator's campaign manager, arranged payment by corporation of $12,000 to Senator's advertising firm in payment of one month's services to Senator's campaign was sufficient to state an offense against campaign manager for causing advertising firm to do that which, if done directly by him, would have constituted acceptance of illegal corporate campaign contribution. U.S. v. Chestnut, D.C.N.Y.1975, 394 F.Supp. 581.

Indictment charging conspiracy to violate former section 610 of Title 18 prohibiting labor unions from making political contributions was not subject to dismissal on ground that it charged three distinct conspiracies, therefore making it duplicitous, where indictment charged a continuing conspiracy. U.S. v. Boyle, D.C.D.C.1972, 338 F.Supp. 1028.

Indictment charging that defendant corporation had made unlawful expenditures in connection with primary election was insufficient for failure to disclose whether expenditures violated wishes of a stockholder. U.S. v. Lewis Food Co., D.C.Cal.1964, 236 F.Supp. 849.

28. Bill of particulars

Defendant, charged with violation of former section 610 of Title 18 relating to expenditures by national bank in connection with an election, and with misapplication of funds by bank officer or employee, was entitled to a bill of particulars fully and fairly advising him of the details of the government's charges, in order that he might properly prepare whatever defense he might have under the circumstances, in order to avoid prejudicial surprise at trial. U.S. v. Barket, D.C.Mo.1974, 380 F.Supp. 1018.

29. Intervention

Even if union were able to allege a sufficient interest to warrant its intervention of right in corporation's action

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against the Federal Election Commission challenging corporate campaign contribution provision of this section, its claim for intervention of right would also fail because its interest was adequately represented by the Commission. Athens Lumber Co., Inc. v. Federal Election Com'n, C.A.Ga.1982, 690 F.2d 1364.

30. Double jeopardy

Following acquittal of corporate defendant on charge of making political contributions in violation of former section 610 of Title 18 [now covered by this section], appeal by the Government was precluded as violative of double jeopardy clause of U.S.C.A. Const. Amend. 5. U.S. v. Security Nat. Bank, C.A.N.Y.1976, 546 F.2d 492, certiorari denied 97 S.Ct. 1591, 430 U.S. 950, 51 L.Ed.2d 799.

President of international union was not placed twice in jeopardy by reason of conviction of having consented to unlawful contribution of labor union funds to the campaigns of candidates for federal office, unlawful conversion of union funds for purpose of making such contribution, and conspiracy to commit such offenses. U.S. v. Boyle, 1973, 482 F.2d 755, 157 U.S.App.D.C. 166, certiorari denied 94 S.Ct. 593, 414 U.S. 1076, 38 L.Ed.2d 483.

Fact that substantive counts were in part based on allegations underlying conspiracy charge in prosecution charging violation of former section 610 of Title 18 prohibiting labor unions from making political contributions did not constitute a violation of defendants' right under U.S.C.A. Const.Amend. 5 against being placed in double jeopardy. U.S. v. Boyle, D.C.D.C.1972, 338 F.Supp. 1028.

31. Limitations

Where indictment charging conspiratorial and substantive violations of former section 610 of Title 18 prohibiting labor unions from making political contributions indicated that last overt act occurred on or about June 10, 1969, indictment was founded well within the five-year period of limitation and was not barred. U.S. v. Boyle, D.C.D.C.1972, 338 F.Supp. 1028.

32. Speedy trial

Fact that five-year statute of limitations applicable to defendant's alleged illegal bank loan to political organizations was not due to expire until 13 months after indictment was filed did not foreclose defendant from asserting prejudice from preindictment delay. U.S. v. Barket, C.A.Mo.1976, 530 F.2d 189.

Where indictment which charged conspiratorial and substantive violations of former section 610 of Title 18 prohibiting labor unions from making political contributions and which was returned on Mar. 2, 1971 was superseded by a subsequent indictment which was returned on Oct. 4, 1971, and where only delay in case was caused by necessity of getting a transcript prepared from motions, hearings for which were held in September of 1971, in order to argue supplemental motions filed with respect to new indictment, case was proceeding in an orderly manner and defendants were not denied their constitutional rights to a speedy trial and due process. U.S. v. Boyle, D.C.D.C.1972, 338 F.Supp. 1028.

33. Motion to dismiss

In prosecution of corporation for making illegal campaign contributions and of corporate officer for consenting to same, factual issues concerning various alleged payments and possible illegal transfers between corporation and officer were part of general issue to be resolved only at trial, not on motions, such as motions to dismiss supported by affidavit that checks from corporation cleared bank more than five years prior to filing of information, five years being the limitation period. U.S. v. Andreas, D.C.Minn.1974, 374 F.Supp. 402.

34. Discovery and inspection

Government responses in prosecution of union and union officials for alleged violations of former section 610

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of Title 18 to pretrial disclosure orders failed to comply with orders, in that composition of special political action fund was not disclosed, circumstances of contributions to fund were not disclosed, and alleged overt acts were not disclosed, warranting dismissal of indictment. U.S. v. Seafarers Intern. Union of North America, D.C.N.Y.1972, 343 F.Supp. 779.

Subpoena duces tecum issued against government prosecutors for production of such evidence in their possession as was being used in prosecutions of defendants for violation of former section 610 of Title 18 prohibiting labor unions from making political contributions would be quashed, notwithstanding proffer of defendant establishing possibility that those who accepted or received alleged contributions were not being prosecuted, since proof of a violation by one who receives a contribution is of a wholly different character from that required to establish a violation by a donor, and defendants did not make a clear showing of relevance and materiality as required. U.S. v. Boyle, D.C.D.C.1971, 338 F.Supp. 1025, motion denied 331 F.Supp. 1181.

35. Summary judgment

In action by stockholder against directors of corporation based on alleged violation of prohibition of former section 610 of Title 18 against corporate expenditures in campaigns for federal office, material factual issue existed as to whether corporation's ad and pamphlet were nonpartisan, thus precluding summary judgment. Ash v. Cort, C.A.Pa.1974, 496 F.2d 416, reversed on other grounds 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

36. Presumptions

If "voluntary" and "involuntary" union funds are commingled and then a portion is expended for political purposes, it will be presumed that expenditures from commingled funds consisted of proportionate shares of the different types of money and it is irrelevant that the government show the source of all funds contributed to political campaigns if a substantial, or huge, portion of money in the funds was "involuntary" at the time of the contribution. U.S. v. Boyle, 1973, 482 F.2d 755, 157 U.S.App.D.C. 166, certiorari denied 94 S.Ct. 593, 414 U.S. 1076, 38 L.Ed.2d 483.

37. Burden of proof

Stockholders who brought derivative action against communications corporation and certain of its directors for failure to collect debt owed by national committee of political party for communication services provided at party's convention, and who alleged that failure to collect the debt was in violation of prohibition of former section 610 of Title 18 against corporate campaign spending, had burden of establishing nexus between alleged gift and a federal election. Miller v. American Tel. & Tel. Co., C.A.Pa.1974, 507 F.2d 759, on remand 394 F.Supp. 58.

In order to obtain conviction under former section 610 of Title 18, the government had to prove beyond reasonable doubt that a labor organization made a contribution or expenditure in connection with the specified federal election for purpose of active electioneering and that the defendant union officer consented to the making of the contribution. U.S. v. Boyle, 1973, 482 F.2d 755, 157 U.S.App.D.C. 166, certiorari denied 94 S.Ct. 593, 414 U.S. 1076, 38 L.Ed.2d 483.

38. Admissibility of evidence

In prosecution for knowingly causing another to accept or receive illegal corporate campaign contribution, proof of similar acts on defendant's part in accepting three other contributions was admissible as tending to show pattern of conduct on issues of knowledge and intent at time of events charged in indictment. U.S. v. Chestnut, D.C.N.Y.1975, 399 F.Supp. 1292, affirmed 533 F.2d 40, certiorari denied 97 S.Ct. 88, 429 U.S. 829, 50 L.Ed.2d 93.

39. Weight and sufficiency of evidence

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Evidence in prosecution for having consented to unlawful contribution of labor union funds to campaigns of candidates for federal office was sufficient to establish that president of international union knew and approved of practice of having checks on union account made out to cash, deposited in personal accounts of members and contributions then made with personal checks and that president knew and approved of efforts to conceal source of the funds. U.S. v. Boyle, 1973, 482 F.2d 755, 157 U.S.App.D.C. 166, certiorari denied 94 S.Ct. 593, 414 U.S. 1076, 38 L.Ed.2d 483.

Evidence was sufficient to sustain conviction of causing another to accept or receive illegal corporate campaign contribution. U.S. v. Chestnut, D.C.N.Y.1975, 399 F.Supp. 1292, affirmed 533 F.2d 40, certiorari denied 97 S.Ct. 88, 429 U.S. 829, 50 L.Ed.2d 93.

In prosecution against union and its president and its secretary for contribution or expenditure of union funds in behalf of candidate for election to Congress, evidence was insufficient to show that expenditure was made by union on behalf of candidate in respect to purchase of gasoline and repair of automobiles. U.S. v. Construction & General Laborers Local Union No. 264, D.C.Mo.1951, 101 F.Supp. 869.

40. Questions for jury

Indictment alleging violation of prohibition of former section 610 of Title 18 against corporate campaign contributions by corporation's advertisements employing rating system to show percentage of each incumbent officer's "votes cast in favor of constitutional principles" was not dismissible as matter of law on ground that expenditures in question were not for an activity which constituted active electioneering, and indictment and advertisements presented jury question as to whether advertisements went beyond permissible bounds in that they were designed to influence public at large to vote for or against particular candidates. U.S. v. Lewis Food Co., C.A.Cal.1966, 366 F.2d 710.

41. Moot questions

Where basis of election controversy remains after the election and where the dispute is likely to reoccur, the case will not be found moot, even where prospective relief alone is sought. Ash v. Cort, C.A.Pa.1974, 496 F.2d 416, reversed on other grounds 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

42. Instructions

Jury should have been instructed in prosecution of union and its officers for conspiring to violate former section 610 of Title 18 prohibiting union from making contribution or expenditure in connection with federal election with respect to issue of voluntariness of payments to fund, and giving instructions permitting jury to convict without finding that donations to fund had been actual or effective dues or assessments was plain error. Pipefitters Local Union No. 562 v. U.S., Mo.1972, 92 S.Ct. 2247, 407 U.S. 385, 33 L.Ed.2d 11.

43. Damages

There was no indication in legislative history of former section 610 of Title 18 which suggested a congressional intent to vest in corporate shareholders a federal right to damages for violation of said section. Cort v. Ash, Pa.1975, 95 S.Ct. 2080, 422 U.S. 66, 45 L.Ed.2d 26.

44. Injunction

Finding in stockholder's suit, brought on behalf of himself and of corporation, that plaintiff would not be irreparably harmed by denial of his request for preliminary injunction to enjoin corporation from furnishing funds for the publication and dissemination of a speech made by the corporation's president was not clearly erroneous despite contention that such publication and dissemination violated former section 610 of Title 18. Ash v. Cort, C.A.Pa.1973, 471 F.2d 811.

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Injunction prohibiting corporation from repeating violation of Federal Election Campaign Act was appropriate where corporation maintained in open court that they had not violated federal election laws and refused to promise that they would not repeat transaction. Federal Election Com'n v. NRA Political Victory Fund, D.D.C.1991, 778 F.Supp. 62.

In action brought by the Federal Election Commission charging a corporation and its chief executive officer with violations of former section 610 of Title 18, plaintiff's demand for injunctive relief was not subject to dismissal. Federal Election Commission v. Weinsten, D.C.N.Y.1978, 462 F.Supp. 243.

Where suit against corporation for direct damages for violation of former section 610 of Title 18 was dismissed because no private right of action existed for direct damages and because plaintiff stockholders failed to satisfy jurisdictional amount requirement, additional claim for injunctive relief could not be maintained under the doctrine of pendent jurisdiction. Miller v. American Tel. & Tel. Co., D.C.Pa.1975, 394 F.Supp. 58, affirmed 530 F.2d 964.

45. Disbarment or suspension from practice

Engaging in covert, deceitful activities on behalf of reelection of President of United States, designed to sow confusion among candidates of opposing party, and convictions of conspiracy and distributing political campaign material not containing name of distributing person or organization warrants suspension for two years, probation for three subsequent years and passing professional responsibility examination. Segretti v. State Bar, Cal.1976, 544 P.2d 929, 126 Cal.Rptr. 793.

46. Scope of review

Evidence was required to be viewed in light most favorable to the government on appeal from conviction of labor union and officers for conspiring to violate former section 610 of Title 18 prohibiting labor organizations from making contributions and expenditures to candidates for federal office. U.S. v. Pipefitters Local Union No. 562, C.A.Mo.1970, 434 F.2d 1116, adhered to 434 F.2d 1127, reversed in part, vacated in part on other grounds 92 S.Ct. 2247, 407 U.S. 385, 33 L.Ed.2d 11.

47. Issues reviewable

Appellant would be allowed to challenge constitutionality of provision of this section despite his failure to do so in district court proceedings for enforcement of Commission subpoena. Federal Election Commission v. Lance, C.A.Ga.1981, 635 F.2d 1132, appeal dismissed, certiorari denied 101 S.Ct. 3151, 453 U.S. 917, 69 L.Ed.2d 999.

On appeal from dismissal of stockholders' derivative action against corporation and certain of its directors for failure to collect debt owed corporation by national committee of political party for communication services furnished by the corporation, direct federal cause of action would not be implied in favor of stockholders against directors for alleged violation of prohibition of former section 610 of Title 18 against corporate campaign spending and section 202(a) of Title 47 where federal law count was not included in complaint and there was no indication that question had ever been presented to district court. Miller v. American Tel. & Tel. Co., C.A.Pa.1974, 507 F.2d 759, on remand 394 F.Supp. 58.

2 U.S.C.A. § 441b

2 USCA § 441b

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The UNITED STATES
v.
Patrick J. CLIFFORD et al.

No. 75--CR--654.

United States District Court,
E.D. New York.

March 3, 1976.

In prosecution arising out of an alleged conspiracy to cause a national bank to make illegal campaign contributions, defendants moved for dismissal of various counts of the indictment. The District Court, Costantino, J., held that statute making it unlawful for any national bank to make a contribution in connection with any election to any political office does not infringe First Amendment rights as applied to national banks; that statute applies to state judicial elections and applies to postelection contributions when made for the purpose of influencing the election; and that statute prohibiting any false statements in any matter within the jurisdiction of any federal department or agency applies to oral unsworn statements even when the defendant has not initiated the investigation.

Motions denied.

[1] CONSTITUTIONAL LAW ⚿ 82(8)
92k82(8)
Formerly 92k82
Statute prohibiting political contributions or expenditures by national banks, corporations or labor organizations does not infringe First Amendment rights insofar as applied to national banks. 18 U.S.C.A. § 610; U.S.C.A.Const. Amend. 1.

[1] ELECTIONS ⚿ 311
144k311
Statute prohibiting political contributions or expenditures by national banks, corporations or labor organizations does not infringe First Amendment rights insofar as applied to national banks. 18 U.S.C.A. § 610; U.S.C.A.Const. Amend. 1.

[2] BANKS AND BANKING ⚿ 233
52k233
Congress may exercise plenary regulatory powers over national banks.

[3] CRIMINAL LAW ⚿ 13.1(2.5)
110k13.1(2.5)
Formerly 110k13.1(2)
Statute making it unlawful for any national bank to make a contribution in connection with any election to any political office is not unconstitutionally vague. 18 U.S.C.A. § 610.

[4] CRIMINAL LAW ⚿ 1078
110k1078
Statute providing that district court shall certify all questions of constitutionality of statute prohibiting political contributions by national banks was not applicable to criminal prosecution for violation of the latter statute. 18 U.S.C.A. § 610; Federal Election Campaign Act of 1971, § 315, 2 U.S.C.A. § 437h.

[5] ELECTIONS ⚿ 317.2
144k317.2
Formerly 144k317.1, 144k317
Statute making it unlawful for any national bank to make a contribution in connection with any election to any political office is applicable to state elections. 18 U.S.C.A. § 610.

[6] ELECTIONS ⚿ 317.2
144k317.2
Formerly 144k317.1, 144k317
Statute making it unlawful for any national bank to make a contribution in connection with any election to any political office is applicable to contributions to judicial elections. 18 U.S.C.A. § 610.

[7] ELECTIONS ⚿ 311
144k311
In prosecution for violation of statute making it unlawful for any national bank to make a contribution in connection with any election to any political office, court would interpret the statute in light of its language and purpose. 18 U.S.C.A. § 610.

[8] COURTS ⚿ 89
106k89
Even if no prosecutions had ever been instituted for judicial contributions under statute making it unlawful for any national bank to make a contribution in connection with any election to any political office, the interpretation of the statute by

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various United States attorneys would not be binding on court in prosecution for violation of the statute. 18 U.S.C.A. § 610.

[9] ELECTIONS ⚿ 311
144k311
Ambiguity in statute prohibiting political campaign contributions by national banks would be resolved in favor of lenity. 18 U.S.C.A. § 610.

[10] ELECTIONS ⚿ 329
144k329
To prove a violation of statute prohibiting political campaign contributions by national banks in making postelection contributions, there must be proof of an intent to influence the election. 18 U.S.C.A. § 610.

[11] FRAUD ⚿ 68.10(3)
184k68.10(3)
Statute prohibiting the making of false statements in any matter within the jurisdiction of any federal department or agency was applicable to oral unsworn statements made to a bank examiner even if defendants had not initiated the investigation. 18 U.S.C.A. § 1001.

[12] INDICTMENT AND INFORMATION ⚿ 144.2
210k144.2
Defendants' motions to dismiss counts of complaint charging conspiracy to cause national bank to make illegal campaign contributions, wherein one defendant alleged that he was not an active member of the conspiracy at the time of the contributions charged and codefendant claimed undue delay in prosecution, would be denied without prejudice. 18 U.S.C.A. § 610.

***1071** David G. Trager, U.S. Atty., E.D.N.Y., Thomas R. Pattison, Edward R. Korman, Robert F. Katzberg, Asst. U.S. Attys., Brooklyn, N.Y., for the U.S.

Orans, Elsen & Polstein, new York City, for defendant Patrick Clifford; Gary P. Naftalis, Gary H. Greenberg, New York City, of counsel.

Joseph W. Ryan, Jr., Mineola, N.Y., for defendant Frank Powell.

Irving A. Cohn, Mineola, N.Y., for defendant David J. Dowd.

Lord, Day & Lord, New York City, for defendant Security National Bank; Eugene F. Bannigan, John W. Castles, III, New York City, of counsel.

MEMORANDUM AND ORDER

COSTANTINO, District Judge.

The 22 count indictment in this case arises out of an alleged conspiracy to cause the Security National Bank to make illegal campaign contributions from 1966--1974. 18 U.S.C. §§ 610, 659, 1001.

Defendants have made various procedural motions. Since this court finds those motions to be without merit, they are denied.

Defendants have also moved for dismissal of various counts of the indictment on numerous grounds. Among the issues raised are (1) the constitutionality of § 610, (2) the applicability of § 610 to state elections, (3) the applicability of § 610 to judicial elections, (4) the applicability of § 610 to post-election contributions, and (5) the applicability of § 1001 to oral unsworn statements made to a bank examiner.

1. The Constitutionality of 18 U.S.C. § 610

Defendants argue that § 610 is an unconstitutional burden on freedom of speech in light of the recent Supreme Court opinion, Buckley v. Valeo, 424 U.S. 1, 96 S.Ct. 612, 46 L.Ed.2d 659 ($75--436, Jan. 30, 1976). In that decision, the Supreme Court held that the expenditure provisions of portions of the Federal Election Campaign Act violated the First Amendment.

***1072** [1][2] Buckley v. Valeo is distinguishable from the case at bar, however. The prohibitions of § 610 insofar as they apply to this case are specifically directed to national banks. Since Congress has chartered national banks it seems clear that Congress may exercise plenary regulatory powers over such institutions. It is concluded that § 610 insofar as it relates to contributions is a valid exercise of this power and does not infringe defendants' First Amendment rights.

Since the government has indicated at oral argument that its proof will be directed solely to the issue of contributions, this court need not decide

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whether the § 610 prohibition on expenditures by national banks is unconstitutional in light of Buckley v. Valeo.

Defendants have also argued that § 610 is unconstitutionally vague. The standard for determining whether a penal statute is unconstitutionally vague was enunciated in Connally v. Gen'l Construction Co., 269 U.S. 385, 391, 46 S.Ct. 126, 127, 70 L.Ed. 322, 328 (1925):

> That the terms of a penal statute creating a new offense must be sufficiently explicit to inform those who are subject to it what conduct on their part will render them liable to its penalties, is a well-recognized requirement, consonant alike with ordinary notions of fair play and the settled rules of law. And a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law. (citations omitted)

[3] Having examined the statute in light of these standards, this court concludes that § 610 is not unconstitutionally vague.

[4] This court has given careful consideration to defendant Dowd's argument that the question of constitutionality should be certified to the U.S. Court of Appeals for the 2d Circuit pursuant to 2 U.S.C. § 437h. [FN1] A review of the language of that section and its legislative history has convinced this court, however, that the provisions of the section are not applicable to the case at bar. The Joint Explanatory Statement of the Committee on Conference, for this section states:

> FN1. 2 U.S.C. § 437h provides as follows: (a) The Commission, the national committee of any political party, or any individual eligible to vote in any election for the office of President of the United States may institute such actions in the appropriate district court of the United States, including actions for declaratory judgment, as may be appropriate to construe the constitutionality of any provision of this Act or of section 608, 610, 611, 613, 614, 615, 616, or 617 of Title 18. The district court immediately shall certify all questions of constitutionality of this Act or of section 608, 610, 611, 613, 614, 615, 616, or 617 of Title 18 to the United States court of appeals for the circuit involved, which shall hear the matter sitting en banc.

> Conference substitute
> The conference substitute generally follows the House amendment and makes it clear that these special judicial review provisions are available only for actions directed at determining the constitutionality of provisions of the Act and of provisions of title 18, United States Code, related to the activities regulated by the Act.
> 1974 U.S.Code Cong. & Admin.News, p. 5664

The case at bar was not directed at determining the constitutionality of the Act. Rather this is a criminal action; the constitutional attack was raised by way of motion. There is no need for the expedited review provision of § 437h in a criminal action, since review may be had on appeal. Declaratory judgments regulate prospective actions; this criminal case deals with actions already taken. Accordingly, there is no reason for certifying the question to the Court of Appeals.

2. The Applicability of § 610 to state elections

[5] Defendants contend that § 610 should apply only to contributions made ***1073** in connection with federal elections and not to state elections. They cite Ash v. Cort, 3 Cir., 496 F.2d 416, rev'd on other grounds, 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975) for the proposition that the definitions contained in 18 U.S.C. § 591 limit the scope of s 610. Ash v. Cort was a civil case dealing with corporate contributions. The prohibitions against national banks in § 610 is different from the prohibition against other corporations in the same section, and the definitions in § 591 only apply 'except as otherwise specifically provided.' The language of § 610 applicable to the case at bar clearly provides otherwise: 'It is unlawful for any national bank . . . to make a contribution or expenditure in connection with any election to any political office . . .' (emphasis added). This language is even more significant in light of the more limited language used in the part of the section dealing with corporations in general:

> . . . or for any corporation whatever, or any labor organization to make a contribution or expenditure in connection with any election at which Presidential and Vice Presidential electors or a Senator or Representative in, or a Delegate or

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> Resident Commissioner to Congress are to be voted for, or in connection with any primary election or political convention or caucus held to select candidates for any of the foregoing offices . . ..

The conclusion that the part of the section relating to national banks was meant to apply to all elections--state as well as federal--is further reinforced by reference to the legislative history. See S.Rep. No. 3056, 59 Cong. 1st Sess. p. 2:

> The effect of this provision is to make it unlawful for any corporation, (organized by authority of any laws of Congress), no matter what its character may be, to make a contribution 'in connection with any election to any political office' without regard to whether the election be national, State, county, township, or municipal. The congress has the undoubted right thus to restrict and regulate corporations of its own creation.

3. The Applicability of § 610 to judicial elections

[6] In arguing that § 610 should not be applied to contributions to judicial elections, defendants rely on two arguments: (1) the alleged failure in the past to prosecute for contributions to judicial elections and (2) a perceived distinction between judicial and political elections. These arguments are without merit.

[7] Assuming arguendo that no prosecution has ever been instituted for contributions to judicial office, this court must nevertheless interpret § 610 in light of its language and purpose. Defendants' argument apparently proceeds as follows: (1) no prosecutions have ever been instituted for judicial contributions, (2) there must have been occasions when the various United States Attorneys' offices were aware of bank contributions to judicial campaigns, (3) therefore, by failing to prosecute, the government indicated its belief that judicial campaigns were insulated from the section's prohibitions.

[8] Only two things need be said about this argument. First, this court is not prepared to speculate as to the reasons for the absence of similar prosecutions. Second, even if this court were able to discern the interpretation of this section by various United States Attorneys in the past, that interpretation would not be binding under the circumstances present here.

Defendants rely on Rosenthal v. Harwood, 35 N.Y.2d 469, 363 N.Y.S.2d 937, 323 N.E.2d 179 (1974) for the proposition that a distinction exists between political and judicial campaigns. To the extent that such a distinction is present in Rosenthal, however, it is based on the need to insulate judicial elections, more than any other election, from corruption or the appearance of corruption. The Court specifically held that 'public policy . . . mandates that insofar as practicable both selection for an performance ***1074** in judicial office shall be free from political manipulation.' 363 N.Y.S.2d at 943, 323 N.E.2d at 183. It seems clear that this rationale requires, rather than precludes, application of § 610 to judicial elections.

In Buckley v. Valeo, supra, 424 U.S. at p. 26, 96 S.Ct. at p. 638, 46 L.Ed.2d at p. 692, the Supreme Court recognized that the primary purpose of the Federal Election Campaign Act was 'to limit the actuality and appearance of corruption . . ..' These public policy considerations clearly mandate that the words of the section--'any election to any political office'--be given their plain meaning. Accordingly, it is concluded that s 610 does apply to contributions made to judicial campaigns.

4. Applicability of § 610 to post election contributions

Defendant Clifford argues that Count 15 of the indictment must be dismissed because it alleges a contribution made after the election. Defendant contends that to establish a violation of § 610 some sort of 'active electioneering' must be proved, see, e.g., U.S. v. Boyle, 157 U.S.App.D.C. 166, 482 F.2d 755 (1973), cert. denied, 414 U.S. 1076, 94 S.Ct. 593, 38 L.Ed.2d 483 (1973). The government has argued that the exclusion of postelection contributions from the language of § 610 would 'create a loophole so wide that it would consume the entire statute.'

[9][10] There appears to be merit to both propositions; the wording of the statute, at the time of the contribution was ambiguous. [FN2] This court must resolve the ambiguity in favor of lenity. Rewis v. U.S., 401 U.S. 808, 812, 91 S.Ct. 1056, 1059, 28 L.Ed.2d 493, 496 (1971); Bell v. U.S.,

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349 U.S. 81, 83, 75 S.Ct. 620, 622, 99 L.Ed. 905, 910 (1955). It is therefore concluded that to prove a violation of s 610, under the circumstances of this case, an intent to influence the election must be proved. Cf. Miller v. American Tel. & Tel. Co., 507 F.2d 759 (3d Cir. 1974); U.S. v. Lewis Food Co., 366 F.2d 710 (9th Cir. 1966).

> FN2. It is probable, although this court need not decide the issue, that by amending the last paragraph of § 610 in 1972, Congress has closed any loophole that existed.

This court, however, cannot conclude as a matter of law that the post-election contribution alleged in Count 15 was not made for the purpose of influencing the election. Resolution of that issue is within the province of a jury after hearing all the facts and circumstances surrounding the contribution. Accordingly, the motion to dismiss Count 15 is denied at this time.

5. The Applicability of 18 U.S.C. § 1001 to oral unsworn statements made to a Bank Examiner

[11] Counts 21 and 22 of the indictment charge defendant Clifford with making false statements in a matter within the jurisdiction of the Office of the Comptroller of the Currency in violation of 18 U.S.C. § 1001. Clifford argues that § 1001 does not apply to oral unsworn statements when the defendant has not initiated the investigation, citing U.S. v. Bedore, 455 F.2d 1109 (9th Cir. 1972).

The United States Court of Appeals for the Second Circuit, however, has construed § 1001 in very broad terms. See U.S. v. McCue, 301 F.2d 452 (2d Cir. 1962); U.S. v. Adler, 380 F.2d 917 (2d Cir. 1967). In McCue a conviction under § 1001 was upheld despite the fact that the investigation was not initiated by the defendant. In Adler the court noted that the word 'statement' as it appears in the statute has been interpreted to include oral statements not under oath. 380 F.2d at 922.

The 'exculpatory--no' cases are not applicable to the facts of this case. Accordingly the motion to dismiss Counts 21 and 22 is denied.

6. Powell's Motion to Dismiss

[12] Defendant Powell moves to dismiss Counts 3, 5, 9, 17 and 19 on the ***1075** ground that, as a matter of law, he was not an active member of the conspiracy at the time the contributions charged in those counts were made. This motion is denied without prejudice. See Pinkerton v. U.S., 328 U.S. 640, 646, 66 S.Ct. 1180, 1183, 90 L.Ed. 1489, 1496 (1945). Hyde v. U.S., 225 U.S. 347, 369, 32 S.Ct.

793, 803, 56 L.Ed. 1114, 1127 (1912). 7. Clifford's Motion to dismiss because of undue delay in prosecution

This court cannot decide at this time whether or not there was prejudicial delay, for, as the brief on behalf of Mr. Clifford states, there 'may well be substantial' prejudice. (emphasis added) Rather than speculate as to whether there may or may not be prejudice during trial this court denies the motion without prejudice.

Accordingly, defendants' motions to dismiss are denied. Defendants' motions to strike 'surplusage' and to sever various counts of the indictment are also denied.

So ordered.

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CLIENT IDENTIFIER: EHJ
DATE OF REQUEST: 05/23/95
THE CURRENT DATABASE IS AR-ST-ANN

ARKANSAS CODE OF 1987 ANNOTATED
TITLE 23. PUBLIC UTILITIES AND REGULATED INDUSTRIES
SUBTITLE 2. FINANCIAL INSTITUTIONS AND SECURITIES
CHAPTER 34. MISCELLANEOUS VIOLATIONS OF BANKING LAWS

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Current through Act 70 of the 1994 Second Extraordinary Session

23-34-107 Embezzlement, misuse of funds, etc., by officer, director, etc.

(a) The following persons shall be guilty of a felony:

(1) Any officer, director, agent, or employee of any bank or trust company who:

(A) Embezzles, abstracts, or willfully misapplies any of the moneys, funds, or credits of the bank or trust company; or

(B) Without authority from the directors of the bank or trust company issues or puts forth any certificate of deposit; draws any order or bill of exchange; makes any acceptance; or assigns any note, bond, draft, bill or exchange, mortgage, judgment, or decree; or

(C) Makes any false entry in any book, report, or statement of the bank or trust company with the intent in any case to injure or defraud the bank or trust company, or any company, body politic or corporate, or any individual person or to deceive any officer of the bank or trust company, or the Bank Commissioner, or any agent or examiner appointed to examine the affairs of the bank or trust company, or the State Banking Board;

(2) Every receiver or liquidating agent of a bank or trust company who, with like intent to defraud or injure, shall embezzle, abstract, purloin, or willfully misapply any of the moneys, funds, or assets of his trust;

(3) Every agent, attorney, employee, or assistant of any receiver or liquidating agent of any bank or trust company who, with like intent to defraud or injure, shall embezzle, abstract, purloin, or willfully misapply any of the moneys, funds, or assets of the trust of the receiver or liquidating agent; and

(4) Every person who, with like intent, shall aid or abet any officer, director, receiver, liquidating agent, employee, agent, attorney, or receiver in any violation of this section.

(b) Upon conviction, the person shall be fined in any sum not more than five thousand dollars ($5,000) or shall be imprisoned in the Arkansas penitentiary for not more than five (5) years, or both.

History. Acts 1933, No. 60, § 10; Pope's Dig., § 693; A.S.A. 1947, § 67-706.

CASE NOTES

Cited: Donaghey v. Wasson, 190 Ark. 1123, 82 S.W.2d 856 (1935).

A.C.A. § 23-34-107

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DATE AND TIME PRINTING STARTED:	05/23/95	03:05:46 pm (Central)
DATE AND TIME PRINTING ENDED:	05/23/95	03:11:01 pm (Central)
OFFLINE TRANSMISSION TIME:		00:05:15
NUMBER OF REQUESTS IN GROUP:	4	
NUMBER OF LINES CHARGED:	3254	

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UNITED STATES of America, Appellee,
v.
Alexander J. BARKET, Appellant.
Alexander J. BARKET, Petitioner,
v.
The Honorable John W. OLIVER, United States District Judge, and United States of America, Respondents.

Nos. 75--1568, 75--1569.

United States Court of Appeals,
Eighth Circuit.

Submitted Nov. 14, 1975.

Decided Dec. 9, 1975.
Rehearing and Rehearing En Banc Denied Feb. 9, 1976.
Rehearing Denied in No. 1568

Order denying motion to dismiss affirmed; petition for writ of mandamus denied.

Stephenson, Circuit Judge, filed a concurring and dissenting opinion.

[1] CRIMINAL LAW ⚿ 1023(8)
110k1023(8)
Ordinarily, absent compelling reasons, an interlocutory order, such as an order denying a motion to dismiss an indictment, is nonappealable; but where the appellant in good faith contends that another trial is barred by former jeopardy, the general rule does not apply, and the denial of the motion to dismiss is deemed appealable as a collateral order, within the "Cohen" doctrine. 28 U.S.C.A. § 1291.

[2] CRIMINAL LAW ⚿ 1023(3)
110k1023(3)
An appealable collateral order (1) must be a final determination of a claim of right separable from, and collateral to, rights asserted in the action, (2) must be too important to be denied review, in the sense that it presents a serious and unsettled question, and (3) its review cannot, in the nature of the question that it presents, await final judgment because when that time comes it will be too late effectively to review the order and rights conferred will have been lost, probably irreparably. 28 U.S.C.A. § 1291.

[3] CRIMINAL LAW ⚿ 1023(8)
110k1023(8)
Since order denying motion to dismiss was trial court's final determination of defendant's double jeopardy claim, since it was separable from the merits of the case, since, being a question of constitutional right, it was too important to be denied review, and since review of the claim could not await final judgment for the reason that defendant would lose his claimed right to be free from a second trial, the order was appealable. 28 U.S.C.A. § 1291.

[4] DOUBLE JEOPARDY ⚿ 6
135Hk6
Formerly 110k161
Double jeopardy prohibition is meant to spare a once jeopardized defendant not only a subsequent conviction but also a subsequent trial.

[5] DOUBLE JEOPARDY ⚿ 136
135Hk136
Formerly 110k196
Two statutes charge the same offense, for double jeopardy purposes, if the violation of each statute is proved by the same evidence.

[6] BANKS AND BANKING ⚿ 256(3)
52k256(3)
Conviction of a bank officer under statute pertaining to the misapplication of national bank funds requires proof that the officer wilfully misapplied funds for the benefit of himself or another person, for the purpose of defrauding or injuring the bank; in contrast, a conviction under statute pertaining to political contributions by a national bank requires proof that the defendant consented to the contribution or expenditure of the bank's funds in connection with an election, and no purpose to defraud or injure the bank is required. 18 U.S.C.A. §§ 610, 656.

[7] BANKS AND BANKING ⚿ 256(3)
52k256(3)
Statute pertaining to the willful misapplication of national bank funds is meant to protect the funds of banks with a federal relationship, whereas statute pertaining to political contributions by national banks has for one of its purposes the protection of the electoral process from the influence of corporate and union funds. 18 U.S.C.A. §§ 610, 656.

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[8] DOUBLE JEOPARDY ⇐ 139.1
135Hk139.1
Formerly 110k196
National bank officer's acquittal on indictment's second count, charging a violation of willful misapplication statute, did not bar prosecution of him on first count, charging a violation of political contribution statute, since violations of the two statutes must be proved by different evidence and the two counts therefore charged different offenses. 18 U.S.C.A. §§ 610, 656.

[9] INDICTMENT AND INFORMATION ⇐ 189(1)
210k189(1)
One offense is a lesser included offense of another only if, in order to commit the greater offense, it is necessary to commit the lesser.

[10] INDICTMENT AND INFORMATION ⇐ 191(.5)
210k191(.5)
Formerly 210k191
Violation of statute pertaining to political contributions by national banks is not a lesser included offense of a violation of statute pertaining to the willful misapplication of funds by a national bank officer. 18 U.S.C.A. §§ 610, 656.

[11] DOUBLE JEOPARDY ⇐ 1
135Hk1
Formerly 110k161
Where an issue of ultimate fact has been determined by a final judgment in a criminal case, to relitigate the issue in a subsequent trial for a different offense would violate the double jeopardy prohibition.

[12] JUDGMENT ⇐ 951(1)
228k951(1)
Defendant has the burden, in any "Ashe v. Swenson" case, of showing that the verdict or findings of the court in prior case necessarily foreclosed an issue essential to the subsequent prosecution.

[13] JUDGMENT ⇐ 751
228k751
Despite defendant's claim, predicated on the collateral estoppel principle of "Ashe v. Swenson," that the trial judge, in commenting on the weight of the Government's evidence at the time defendant was acquitted on indictment's second count, decided certain factual issues in defendant's favor which were crucial to a prosecution on the indictment's remaining first count, an examination of the record established that none of the statements unambiguously foreclosed issues essential to the first count.

***183** Thomas C. Walsh, St. Louis, Mo., for appellant.

Anthony Nugent, U.S. Asst. Atty., Kansas City, Mo., for appellee.

Before MATTHES, Senior Circuit Judge, LAY and STEPHENSON, Circuit Judges.

MATTHES, Senior Circuit Judge.

Alexander J. Barket has appealed from the order of the district court[FN*] denying his motion to dismiss Count I of a two-count indictment (our Appeal No. 75--1568). Alternatively, Barket filed a petition for writ of mandamus in this court (No. 75--1569) to compel the district court to dismiss Count I and discharge appellant. The appeal and petition for mandamus have been consolidated for briefing, argument, and opinion.

FN* The Honorable John W. Oliver.

Count I of the indictment charged that appellant, an officer of Civic Plaza National Bank, Kansas City, Missouri, consented to the expenditure of the bank's moneys in connection with the 1968 presidential election, in violation of 18 U.S.C. s 610.[FN1]

FN1. In pertinent part s 610 provides: It is unlawful for any national bank, * * * to make a contribution or expenditure in connection with any election to any political office, or in connection with any primary election or political convention or caucus held to select candidates for any political office, * * * (A)nd every officer or director of any corporation, or officer of any labor organization, who consents to any contribution or expenditure by the corporation or labor organization, as the case may be, * * * shall be fined not more than $1,000 or imprisoned not more than one year, or both; and if the violation was willful, shall be fined not more than $10,000 or imprisoned not more than two years, or both.

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Before proceeding to an examination of the merits of the issues presented, a resume of the history of this case in the district court will serve to explain why this litigation is before us.

The two-count indictment was filed on May 9, 1974.[FN2] Count I charged that appellant ***184** violated 18 U.S.C. s 610 by consenting to the contribution of $7,500 of Civic Plaza's money in connection with the 1968 election for presidential and vice presidential electors. Count II charged that, in violation of 18 U.S.C. s 656, appellant knowingly and without authorization misapplied $9,144 of the bank's funds by paying the money to Rudolph Zatezalo, for the purpose of making an unlawful political contribution.[FN3]

FN2. The original indictment in this action was filed on October 11, 1973. The first two counts charged appellant and the bank with the violations alleged here. The third count charged appellant with violating 18 U.S.C. s 1005. This indictment was dismissed on appellant's motion on November 23, 1973. The present indictment was subsequently filed, naming appellant alone as defendant. A separate information against the bank was also filed, but was dismissed by the trial court.

FN3. In pertinent part s 656 provides: Whoever, being an officer, director, * * * or connected in any capacity with any Federal Reserve bank, member bank, national bank or insured bank, * * * embezzeles, 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 fined not more than $5,000 or imprisoned not more than five years, or both * * *.

Both counts were based on the same transactions: an alleged payment of $9,144 from the bank to Zatezalo, as a bonus salary, and a contribution by Zatezalo of $7,500 to the presidential campaign of then Vice President Hubert Humphrey. [FN4] The government's theory is that appellant approved this payment to Zatezalo, without proper authorization, and so violated both s 656, by misapplying the bank's funds, and s 610 by consenting to an expenditure of bank funds for a presidential election.

FN4. The difference between the amount purportedly paid to Zatezalo ($9,144) and the amount of the alleged contribution ($7,500) apparently represented Zatezalo's increased income tax liability resulting from his receipt of the 'bonus.'

At a conference on January 28, 1975, the court ordered that the two counts be tried separately. It is unclear at whose instance this order was made.[FN5]

FN5. The court's memorandum of this conference reads: 'The government elected to try the s 656 counts in the two cases.' The government asserts that the court compelled it to sever the counts for trial, on motion of appellant.

In any event, after waiver of a jury trial, the case proceeded on Count II alone, the s 656 misapplication charge. At the close of the evidence, the trial judge granted appellant's motion for judgment of acquittal. In granting the motion, he discussed at length the strength of the government's evidence. Particularly, he said:

> The greatest difficulty, it seems to me, is proof and evidence to support any sort of finding that whatever the defendant may have done, he did for the purpose as alleged by the government 'to injure and defraud his bank' * * *.
>
> It is my judgment, and I find, that there was an equal failure of proof on the part of the government that the purpose of the defendant's action was the making of an 'illegal' political contribution.

The court then entered a 'not guilty' verdict.

Count I of the indictment, the s 610 charge, remained pending. Thereafter, appellant moved to dismiss this count on several grounds. He asserted first that to try him on Count I would violate the fifth amendment's proscription of double jeopardy, because the offense charged in Count I is identical to the offense charged in Count II. In his motion to dismiss appellant relied in part at least on Ashe v. Swenson, 397 U.S. 436, 90 S.Ct. 1189, 25 L.Ed.2d 469 (1970) to support this double jeopardy claim.[FN6] He asserted also that Count I fails to state an offense, and that s 610 is unconstitutional.

FN6. On appeal, appellant has receded from any claim that Ashe v. Swenson involves pure double jeopardy. He recognizes that Ashe dealt with collateral estoppel, and incorporated that doctrine

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> into the double jeopardy clause of the fifth amendment.

The court denied appellant's motion to dismiss Count I and this appeal followed. ***185** In denying the motion, the judge filed a written memorandum and order in which he stated inter alia:

> In connection with the Section 656 charge contained in Count II of the indictment, the government was obligated to establish beyond reasonable doubt that the defendant, with intent to injure and defraud the bank of which he was an officer and director, willfully and knowingly misapplied $9,144.00 for the purpose of making an unlawful political contribution. The Section 610 charge alleged in Count I does not require proof of any factual data essential to a Section 656 conviction under Count II. The charge in Count I requires that the government prove beyond reasonable doubt that the defendant 'consented' to a $7,500 contribution made by the bank in violation of Section 610. That is an entirely different charge than Count II which alleged that the defendant had made an unidentified unlawful political contribution with money which he had converted from funds formerly owned by the bank.

Initially, we consider the question whether the order complained of is a 'final decision' appealable under 28 U.S.C. s 1291.

The parties disagree on this vital question. The appellant relies on Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528 (1949), and cases cited below from four courts of appeals in support of his contention that even though the order denying the motion to dismiss is collateral in nature, it should be treated as final and appealable. The government argues that the order does not fall within the ambit of the Cohen doctrine and submits that the four cases relied upon by the appellant the distinguishable. The government argues also that the double jeopardy and collateral estoppel issues can be determined after another trial and entry of a final judgment under 28 U.S.C. s 1291.

[1] Ordinarily, absent compelling reasons, an interlocutory order, such as an order denying a motion to dismiss an indictment, is non-appealable. Cohen v. Beneficial Industrial Loan Corp., supra; Snodgrass v. United States, 326 F.2d 409 (8th Cir. 1964). However, where, as here, the appellant in good faith contends that another trial is barred by former jeopardy, this general rule does not apply. Rather, denial of the motion to dismiss is deemed appealable as a collateral order, within the doctrine of Cohen v. Beneficial Industrial Loan Corp., supra. United States v. DeSilvio, 520 F.2d 247 (3d Cir. 1975); United States v. Beckerman, 516 F.2d 905 (2d Cir. 1975); United States v. Lansdown, 460 F.2d 164 (4th Cir. 1972); see also Thomas v. Beasley, 491 F.2d 507 (6th Cir. 1974); contra, United States v. Bailey, 512 F.2d 833 (5th Cir. 1975).[FN7]

> FN7. We agree with the government that the factual contexts of the cases relied upon by appellant are dissimilar from the circumstances here. But central to all of the cases was a double jeopardy plea and, more importantly, whether that issue could be tested and determined on an appeal from an interlocutory judgment such as an appeal from a denial of a motion to dismiss.

[2] The denial of the motion to dismiss in this case has all the characteristics of a collateral order. These characteritics are enumerated by Professor Moore:

> (1) (T)he order must be a final determination of a claim of right 'separable from, and collateral to,' rights asserted in the action;
> (2) it must be 'too important to be denied review,' in the sense that it 'presents a serious and unsettled question'; and
> (3) its review cannot, in the nature of the question that it presents, await final judgment because 'when that time comes, it will be too late effectively to review the * * * order and rights conferred * * * will have been lost, probably irreparably.'

***186** 9 J. Moore, Federal Practice P110.10, quoted in Roach v. Churchman, 457 F.2d 1101 (8th Cir. 1972).

[3] The order denying the motion to dismiss here is the trial court's final determination of appellant's double jeopardy claim. It is separable from the merits of the case. See United States v. Lansdown, supra, 460 F.2d at 171. As a question of constitutional right, it is too important to be denied review. Id.

[4] Most importantly, review of the double

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jeopardy claim cannot await final judgment. The double jeopardy prohibition is meant to spare a once-jeopardized defendant not only a subsequent conviction, but also a subsequent trial. It is designed to prevent the government from 'subjected (a defendant) to embarrassment, expense and orderal and compelling him to live in a continuing state of anxiety and insecurity, as well as enhancing the possibility that even though innocent he may be found guilty.' Green v. United States, 355 U.S. 184, 187--88, 78 S.Ct. 221, 223, 2 L.Ed.2d 199 (1957); Accord United States v. Lansdown, supra, 460 F.2d at 171; United States v. Brown, 481 F.2d 1035, 1041 (8th Cir. 1973); see also Ashe v. Swenson, 397 U.S. 436, 90 S.Ct. 1189, 25 L.Ed.2d 469 (1970).

If this appeal is not heard now, appellant will lose his claimed right to be free from a second trial.[FN8] Review thus cannot await final judgment. We hold that the order is appealable, and in so holding, we emphasize that our conclusion is limited to double jeopardy cases.

> FN8. It makes no difference for appealability purposes, of course, whether appellant wins or loses on the merits. See, e.g., United States v. DeSilvio, supra (finding that order similar to the one here is appealable, and holding for appellee on merits).

Also, the other grounds for dismissal of the indictment advanced by appellant (failure to charge an offense and the unconstitutionality of s 610) can be heard, if necessary, on appeal from final judgment in the event there is another trial and conviction. Accordingly, we do not consider them now. We limit our consideration to appellant's double jeopardy and collateral estoppel claims.

And because we find the order appealable, we need not consider whether mandamus is appropriate.

Appellant in fact makes two separate double jeopardy arguments. First, he contends that the s 610 violation charged in Count I and the s 656 violation charged in Count II are the 'same offense,' so that his acquittal for the latter bars prosecution for the former. Secondly, he argues that the second prosecution is barred by the 'collateral estoppel' rule of Ashe v. Swenson, 397 U.S. 436, 90 S.Ct. 1189, 25 L.Ed.2d 469 (1970). We consider each argument in turn.

[5] Two statutes charge the same offense, for double jeopardy purposes, if the violation of each statute is proved by the same evidence. Blockburger v. United States, 284 U.S. 299, 52 S.Ct. 40, 76 L.Ed. 520 (1932); Kistner v. United States, 332 F.2d 978, 980 (8th Cir. 1964).

[6] Conviction of a bank officer under 18 U.S.C. s 656 requires proof that the officer wilfully misapplied funds for the benefit of himself or another person, for the purpose of defrauding or injuring the bank. This purpose to defraud or injure the bank is an important element of a s 656 offense. See United States v. Giordano, 489 F.2d 327, 330 (2d Cir. 1973).

Conviction under s 610, in contrast, requires proof that the defendant consented to the contribution or expenditure of the bank's funds in connection with an election. No purpose to defraud or injure the bank is required.

[7] There is a fundamental difference in purpose between the two statutes. The misapplication statute, s 656, is meant to protect the funds of banks with a federal relationship. '(C)ourts have generally held that the gist of the offense of willful misapplication is the conversion of funds of a federally insured ***187** bank by one connected in some capacity with the bank either to his own use or to the use of a third person, with the intent to injure or defraud the bank.' United States v. Wilson, 500 F.2d 715, 720 (5th Cir. 1974). The political contribution statute, s 610, in contrast, has for one of its purposes the protection of the electoral process from the influence of corporate and union funds. See United States v. Auto Workers, 352 U.S. 567, 77 S.Ct. 529, 1 L.Ed.2d 563 (1952).

[8] Because of these different purposes, the two offenses contain different elements. As noted, s 656 requires a purpose to injure or defraud the bank; s 610 requires consent to a political contribution. Violations of the two statutes must be proved by different evidence. Therefore, the two counts here charge different offenses.[FN9] See United States v. Blockburger, supra.

> FN9. Appellant makes much of the government's assertion that it will introduce at trial on Count I the

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> same evidence used at the trial of Count II. The question before us is not, however, what evidence is to be used at trial. Rather, the question is what evidence is required to convict under the two statutes.

Appellant in reality is arguing not that the offenses are identical, but that the s 610 violation is a lesser included offense of the s 656 violation.

[9][10] One offense is a lesser included offense of another only if, in order to commit the greater offense, it is necessary to commit the lesser. See United States v. Eisenberg, 469 F.2d 156, 162 (8th Cir. 1972), cert. denied, 410 U.S. 992, 93 S.Ct. 1515, 36 L.Ed.2d 190 (1973). Manifestly, there are many ways to misapply funds, in violation of s 656, without consenting to a political contribution in violation of s 610. It is thus possible to commit the greater offense without committing the lesser, and the lesser included offense doctrine is inapplicable.

The two counts, then, do not charge the same offense. Nor is the offense charged in Count I a lesser included offense of the offense charged in Count II. This aspect of the double jeopardy prohibition is thus inapplicable, and appellant's point is without merit.

[11] Appellant's second argument is based, not on pure double jeopardy, but on the 'collateral estoppel' principle of Ashe v. Swenson, 397 U.S. 436, 90 S.Ct. 1189, 25 L.Ed.2d 469 (1970). The Supreme Court there held that, where an issue of ultimate fact has been determined by a final judgment in a criminal case, to relitigate the issue in a subsequent trial for a different offense violates the double jeopardy prohibition. Appellant contends that the trial judge, in commenting on the weight of the government's evidence, decided certain factual issues in appellant's favor which would be crucial to a prosecution on Count I.

The statement referred to were made from the bench at the close of the evidence at the trial on Count II.[FN10] They lack the clarity which could be found in written findings of fact. It is therefore difficult to determine what factual issues the trial judge intended to resolve by the statements.

> FN10. Appellant did not request formal findings of fact, and none were made. See Fed.R.Crim.P. 23(c). The 'findings' referred to here were oral comments made in the disposition of the motion for judgment of acquittal. Because none forecloses an issue essential to Count I, it is not necessary to consider whether 'findings' of this kind can bring the Ashe v. Swenson rule into play.

As shown above, in ruling on the motion to dismiss which is now before us, the trial judge found that his disposition of Count II had not foreclosed any issues essential to the trial of Count I. We are not bound by this finding. Rather, we must make our own examination of the record, to see what factual issues were resolved in connection with the motion for judgment of acquittal, and which of these issues, if any, would be material to a s 610 prosecution. We note first that the one issue on which the trial court ***188** unquestionably found a failure of proof is not essential to a s 610 proceeding. The court ruled that the government had failed to prove that appellant acted for the purpose of injuring and defrauding his bank. As observed, this is not an element of the s 610 offense, so that this finding does not preclude conviction under that statute.

Appellant relies on certain other 'findings' of the trial court to support his Ashe v. Swenson claim. He points, first, to the trial court's assertion that the evidence did not support a finding that appellant acted 'wilfully.' It is not at all clear what the trial judge meant by his use of the word 'wilful.' He might have meant to say that appellant did not act for the specific purpose of violating s 656, or to assert again that appellant did not act to injure the bank. If so, this 'finding' of lack of wilfulness is irrelevant to the s 610 charge.

Similarly, the court found that 'there was an equal failure of proof on the part of the government that the purpose of the defendant's action was the making of an 'illegal' political contribution.' This comment was made in the midst of a discussion of the requirement that a s 656 misapplication necessarily involve a conversion. The court emphasized the word 'illegal.' It might well have meant to say, not that the government failed to prove the political contribution, but that it failed to prove that the contribution resulted from an unauthorized, i.e., 'illegal,' conversion of bank funds. Conviction under s 610 does not require that the contribution of bank funds be unauthorized. If

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the sentence quoted is given this meaning, prosecution under s 610 remains possible.

Appellant asserts, finally, that the court found that the government failed to prove that appellant was 'tied' to the contribution in question. The record shows that the court did not in fact so find. Although it indicated that there was 'some difficulty' in tying the alleged contribution to appellant in light of certain documentary evidence, it did not expressly rule on the question. In the absence of a clearer declaration by the trial judge, we cannot say that the issue of appellant's participation in the contribution was resolved.

[12][13] In any Ashe v. Swenson case, the burden is on the defendant to show that the verdict or the findings of the court in the prior case necessarily foreclosed an issue essential to the subsequent prosecution. See United States v. Gugliaro, 501 F.2d 68, 70 (2d Cir. 1974). Appellant has not sustained this burden here. None of the statements referred to by appellant unambiguously forecloses issues essential to Count I.

Appellant has thus not shown that the prosecution of Count I is barred by the trial court's disposition of Count II, either under traditional double jeopardy standards or under the rule of Ashe v. Swenson. The trial court therefore did not err in denying the motion to dismiss.

The government has indicated that it will present at the trial of Count I the same evidence it produced at the trial of Count II. We assume that the trial court will provide both parties the opportunity to present additional evidence if they choose to do so.

The petition for writ of mandamus is denied. The order of the district court denying appellant's motion to dismiss is affirmed.

STEPHENSON, Circuit Judge (concurring and dissenting).

Assuming arguendo that the order of the district court denying appellant's motion to dismiss Count I is an appealable order I concur with parts II and III of the majority opinion.

However, I respectfully dissent from part I of the majority opinion because it is my view that the order denying dismissal of Count I is not a final decision appealable under 28 U.S.C. s 1291. I am in accord with the views expressed in United States v. Bailey, 512 F.2d 833 (5th Cir. 1975). Cf. United States v. Nixon, 418 U.S. 683, 690--92, 94 S.Ct. 3090, 41 L.Ed.2d 1039 (1974).

I would deny the petition for writ of mandamus for the reason that exceptional ***189** circumstances justifying invocation of this extraordinary remedy do not exist. Will v. United States, 389 U.S. 90, 95, 88 S.Ct. 269, 19 L.Ed.2d 305 (1967).

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Current through P.L. 104-8, approved 4-17-95

§ 437g. Enforcement

(a) Administrative and judicial practice and procedure

(1) Any person who believes a violation of this Act or of chapter 95 or chapter 96 of Title 26 has occurred, may file a complaint with the Commission. Such complaint shall be in writing, signed and sworn to by the person filing such complaint, shall be notarized, and shall be made under penalty of perjury and subject to the provisions of section 1001 of Title 18. Within 5 days after receipt of a complaint, the Commission shall notify, in writing, any person alleged in the complaint to have committed such a violation. Before the Commission conducts any vote on the complaint, other than a vote to dismiss, any person so notified shall have the opportunity to demonstrate, in writing, to the Commission within 15 days after notification that no action should be taken against such person on the basis of the complaint. The Commission may not conduct any investigation or take any other action under this section solely on the basis of a complaint of a person whose identity is not disclosed to the Commission.

(2) If the Commission, upon receiving a complaint under paragraph (1) or on the basis of information ascertained in the normal course of carrying out its supervisory responsibilities, determines, by an affirmative vote of 4 of its members, that it has reason to believe that a person has committed, or is about to commit, a violation of this Act or chapter 95 or chapter 96 of Title 26, the Commission shall, through its chairman or vice chairman, notify the person of the alleged violation. Such notification shall set forth the factual basis for such alleged violation. The Commission shall make an investigation of such alleged violation, which may include a field investigation or audit, in accordance with the provisions of this section.

(3) The general counsel of the Commission shall notify the respondent of any recommendation to the Commission by the general counsel to proceed to a vote on probable cause pursuant to paragraph (4) (A) (i). With such notification, the general counsel shall include a brief stating the position of the general counsel on the legal and factual issues of the case. Within 15 days of receipt of such brief, respondent may submit a brief stating the position of such respondent on the legal and factual issues of the case, and replying to the brief of general counsel. Such briefs shall be filed with the Secretary of the Commission and shall be considered by the Commission before proceeding under paragraph (4).

(4) (A) (i) Except as provided in clause (ii), if the Commission determines, by an affirmative vote of 4 of its members, that there is probable cause to believe that any person has committed, or is about to commit, a violation of this Act or of chapter 95 or chapter 96 of Title 26, the Commission shall attempt, for a period of at least 30 days, to correct or prevent such violation by informal methods of conference, conciliation, and persuasion, and to enter into a conciliation agreement with any person involved. Such attempt by the Commission to correct or prevent such violation may continue for a period of not more than 90 days. The Commission may not enter into a conciliation agreement under this clause except pursuant to an affirmative vote of 4 of its members. A conciliation agreement, unless violated, is a complete bar to any further action by the Commission, including the bringing of a civil proceeding under paragraph (6) (A).

(ii) If any determination of the Commission under clause (i) occurs during the 45-day period immediately preceding any election, then the Commission shall attempt, for a period of at least 15 days, to correct or prevent

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the violation involved by the methods specified in clause (i).

(B) (i) No action by the Commission or any person, and no information derived, in connection with any conciliation attempt by the Commission under subparagraph (A) may be made public by the Commission without the written consent of the respondent and the Commission.

(ii) If a conciliation agreement is agreed upon by the Commission and the respondent, the Commission shall make public any conciliation agreement signed by both the Commission and the respondent. If the Commission makes a determination that a person has not violated this Act or chapter 95 or chapter 96 of Title 26, the Commission shall make public such determination.

(5) (A) If the Commission believes that a violation of this Act or of chapter 95 or chapter 96 of Title 26 has been committed, a conciliation agreement entered into by the Commission under paragraph (4) (A) may include a requirement that the person involved in such conciliation agreement shall pay a civil penalty which does not exceed the greater of $5,000 or an amount equal to any contribution or expenditure involved in such violation.

(B) If the Commission believes that a knowing and willful violation of this Act or of chapter 95 or chapter 96 of Title 26 has been committed, a conciliation agreement entered into by the Commission under paragraph (4) (A) may require that the person involved in such conciliation agreement shall pay a civil penalty which does not exceed the greater of $10,000 or an amount equal to 200 percent of any contribution or expenditure involved in such violation.

(C) If the Commission by an affirmative vote of 4 of its members, determines that there is probable cause to believe that a knowing and willful violation of this Act which is subject to subsection (d) of this section, or a knowing and willful violation of chapter 95 or chapter 96 of Title 26, has occurred or is about to occur, it may refer such apparent violation to the Attorney General of the United States without regard to any limitations set forth in paragraph (4) (A).

(D) In any case in which a person has entered into a conciliation agreement with the Commission under paragraph (4) (A), the Commission may institute a civil action for relief under paragraph (6) (A) if it believes that the person has violated any provision of such conciliation agreement. For the Commission to obtain relief in any civil action, the Commission need only establish that the person has violated, in whole or in part, any requirement of such conciliation agreement.

(6) (A) If the Commission is unable to correct or prevent any violation of this Act or of chapter 95 or chapter 96 of Title 26, by the methods specified in paragraph (4) (A), the Commission may, upon an affirmative vote of 4 of its members, institute a civil action for relief, including a permanent or temporary injunction, restraining order, or any other appropriate order (including an order for a civil penalty which does not exceed the greater of $5,000 or an amount equal to any contribution or expenditure involved in such violation) in the district court of the United States for the district in which the person against whom such action is brought is found, resides, or transacts business.

(B) In any civil action instituted by the Commission under subparagraph (A), the court may grant a permanent or temporary injunction, restraining order, or other order, including a civil penalty which does not exceed the greater of $5,000 or an amount equal to any contribution or expenditure involved in such violation, upon a proper showing that the person involved has committed, or is about to commit (if the relief sought is a permanent or temporary injunction or a restraining order), a violation of this Act or chapter 95 or chapter 96 of Title 26.

(C) In any civil action for relief instituted by the Commission under subparagraph (A), if the court determines that the Commission has established that the person involved in such civil action has committed a knowing and willful violation of this Act or of chapter 95 or chapter 96 of Title 26, the court may impose a civil penalty which does not exceed the greater of $10,000 or an amount equal to 200 percent of any contribution or expenditure involved in such violation.

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(7) In any action brought under paragraph (5) or (6), subpenas for witnesses who are required to attend a United States district court may run into any other district.

(8) (A) Any party aggrieved by an order of the Commission dismissing a complaint filed by such party under paragraph (1), or by a failure of the Commission to act on such complaint during the 120-day period beginning on the date the complaint is filed, may file a petition with the United States District Court for the District of Columbia.

(B) Any petition under subparagraph (A) shall be filed, in the case of a dismissal of a complaint by the Commission, within 60 days after the date of the dismissal.

(C) In any proceeding under this paragraph the court may declare that the dismissal of the complaint or the failure to act is contrary to law, and may direct the Commission to conform with such declaration within 30 days, failing which the complainant may bring, in the name of such complainant, a civil action to remedy the violation involved in the original complaint.

(9) Any judgment of a district court under this subsection may be appealed to the court of appeals, and the judgment of the court of appeals affirming or setting aside, in whole or in part, any such order of the district court shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of Title 28.

(10) Repealed. Pub.L. 98-620, Title IV, § 402(1)(A), Nov. 8, 1984, 98 Stat. 3357.

(11) If the Commission determines after an investigation that any person has violated an order of the court entered in a proceeding brought under paragraph (6), it may petition the court for an order to hold such person in civil contempt, but if it believes the violation to be knowing and willful it may petition the court for an order to hold such person in criminal contempt.

(12) (A) Any notification or investigation made under this section shall not be made public by the Commission or by any person without the written consent of the person receiving such notification or the person with respect to whom such investigation is made.

(B) Any member or employee of the Commission, or any other person, who violates the provisions of subparagraph (A) shall be fined not more than $2,000. Any such member, employee, or other person who knowingly and willfully violates the provisions of subparagraph (A) shall be fined not more than $5,000.

(b) Notice to persons not filing required reports prior to institution of enforcement action; publication of identity of persons and unfiled reports

Before taking any action under subsection (a) of this section against any person who has failed to file a report required under section 434(a) (2) (A) (iii) of this title for the calendar quarter immediately preceding the election involved, or in accordance with section 434(a) (2) (A) (i) of this title, the Commission shall notify the person of such failure to file the required reports. If a satisfactory response is not received within 4 business days after the date of notification, the Commission shall, pursuant to section 438(a) (7) of this title, publish before the election the name of the person and the report or reports such person has failed to file.

(c) Reports by Attorney General of apparent violations

Whenever the Commission refers an apparent violation to the Attorney General, the Attorney General shall report to the Commission any action taken by the Attorney General regarding the apparent violation. Each report shall be transmitted within 60 days after the date the Commission refers an apparent violation, and every 30 days thereafter until the final disposition of the apparent violation.

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(d) Penalties; defenses; mitigation of offenses

(1) (A) Any person who knowingly and willfully commits a violation of any provision of this Act which involves the making, receiving, or reporting of any contribution or expenditure aggregating $2,000 or more during a calendar year shall be fined, or imprisoned for not more than one year, or both. The amount of this fine shall not exceed the greater of $25,000 or 300 percent of any contribution or expenditure involved in such violation.

(B) In the case of a knowing and willful violation of section 441b(b)(3) of this title, the penalties set forth in this subsection shall apply to a violation involving an amount aggregating $250 or more during a calendar year. Such violation of section 441b(b)(3) of this title may incorporate a violation of section 441c(b), 441f, or 441g of this title.

(C) In the case of a knowing and willful violation of section 441h of this title, the penalties set forth in this subsection shall apply without regard to whether the making, receiving, or reporting of a contribution or expenditure of $1,000 or more is involved.

(2) In any criminal action brought for a violation of any provision of this Act or of chapter 95 or chapter 96 of Title 26, any defendant may evidence their lack of knowledge or intent to commit the alleged violation by introducing as evidence a conciliation agreement entered into between the defendant and the Commission under subsection (a) (4) (A) of this section which specifically deals with the act or failure to act constituting such violation and which is still in effect.

(3) In any criminal action brought for a violation of any provision of this Act or of chapter 95 or chapter 96 of Title 26, the court before which such action is brought shall take into account, in weighing the seriousness of the violation and in considering the appropriateness of the penalty to be imposed if the defendant is found guilty, whether--

(A) the specific act or failure to act which constitutes the violation for which the action was brought is the subject of a conciliation agreement entered into between the defendant and the Commission under subparagraph (a) (4) (A);

(B) the conciliation agreement is in effect; and

(C) the defendant is, with respect to the violation involved, in compliance with the conciliation agreement.

CREDIT(S)

1985 Main Volume

(Pub.L. 92-225, Title III, § 309, formerly § 314, as added Pub.L. 93-443, Title II, § 208(a), Oct. 15, 1974, 88 Stat. 1284, renumbered § 313 and amended Pub.L. 94-283, Title I, §§ 105, 109, May 11, 1976, 90 Stat. 481, 483, renumbered § 309 and amended Pub.L. 96-187, Title I, §§ 105(4), 108, Jan. 8, 1980, 93 Stat. 1354, 1358; Pub.L. 98-620, Title IV, § 402(1)(A), Nov. 8, 1984, 98 Stat. 3357.)

< General Materials (GM) - References, Annotations, or Tables >

HISTORICAL AND STATUTORY NOTES

References in Text

This Act, referred to in subsecs. (a) and (d), means the Federal Election Campaign Act of 1971, as amended, as defined by section 431 of this title.

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Prior Provisions

Provisions similar to those comprising subsec. (a) of this section were contained in section 308(d) of Pub.L. 92-225, Title III, Feb. 7, 1972, 86 Stat. 18 (section 438(d) of this title) prior to amendment of section 308 of Pub.L. 92-225 by Pub.L. 93-443.

1984 Amendment

Subsec. (a)(10). Pub.L. 98-620 struck out par. (10) which had provided that any action brought under subsec. (a) be advanced on the docket of the court in which filed, and put ahead of the other actions (other than other actions brought under this subsection or under section 437h of this title).

1980 Amendment

Pub.L. 96-187, § 108, substantially reworked the provisions of this section in order to facilitate the Commission's more expeditious handling of complaints, and the implementation of enforcement proceedings.

1976 Amendment

Subsec. (a). Pub.L. 94-283, § 109, generally reworked the provisions of subsec. (a) to reflect the enactment of sections 441a to 441j of this title and the repeal of sections 608 and 610 to 617 of Title 18 and to update the operations of the Commission.

Subsec. (b). Pub.L. 94-283, § 109, reenacted subsec. (b) without change.

Subsec. (c). Pub.L. 94-283, § 109, added subsec. (c).

Effective Date of 1984 Amendment

Amendment by Pub.L. 98-620 not to apply to cases pending on Nov. 8, 1984, see section 403 of Pub.L. 98-620, set out as a note under section 1657 of Title 28, Judiciary and Judicial Procedure.

Effective Date of 1980 Amendment

Amendment by Pub.L. 96-187 effective Jan. 8, 1980, see section 301(a) of Pub.L. 96-187, set out as an Effective Date of 1980 Amendment note under section 431 of this title.

Effective Date

Section effective Jan. 1, 1975, see section 410(a) of Pub.L. 93-443 set out as an Effective Date of 1974 Amendment note under section 431 of this title.

Legislative History

For legislative history and purpose of Pub.L. 93-443, see 1974 U.S.Code Cong. and Adm.News, p. 5587. See, also, Pub.L. 94-283, 1976 U.S.Code Cong. and Adm.News, p. 929; Pub.L. 96-187, 1979 U.S.Code Cong. and Adm.News, p. 2860; Pub.L. 98-620, 1984 U.S.Code Cong. and Adm.News, p. 5708.

CROSS REFERENCES

Defense of civil action brought under this section, power of Commission, see 2 USCA § 437d.

WEST'S FEDERAL FORMS

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Contempt proceedings, Civil, see § 5651 et seq. Criminal, see § 7761 et seq.

Jurisdiction and venue in district courts, matters pertaining to, see § 1003 et seq.

Preliminary injunctions and temporary restraining orders, matters pertaining to, see § 5271 et seq.

Sentence and fine, see § 7531 et seq.

CODE OF FEDERAL REGULATIONS

Access to Public Disclosure Division documents, see 11 CFR 5.1 et seq.

Compliance procedure, see 11 CFR 111.1 et seq.

LAW REVIEW COMMENTARIES

Political campaign contributions by foreign nationals in Florida elections. Donna M. Ballman, 65 Fla.B.J. 31 (March 1991).

Regulating newsletters under Federal Elections Laws and the First Amendment. Martin Boles, 40 Ark.L.Rev. 79 (1987).

NOTES OF DECISIONS

Appellate review 22
Arbitrary and capricious standard of review 20
Authority of Attorney General 6
Civil penalty 18
Complaint 12
Conciliation agreement 7
Constitutionality 1
Construction with other laws 2
Contrary to law, review 21
Declaratory and injunctive relief 17
Disclosure 14
Discovery 15

Discretion of
Discretion of - Attorney General 5 Discretion of - Commission 4 Exhaustion of remedies 16
Expeditious handling of complaint 23
Immunity 10a
Injunctive relief 17
Investigations 14a
Jurisdiction 11
Knowledge and willfulness 10
Mandatory nature of section 3
Notice and opportunity for hearing 26
Persons entitled to maintain action 25
Persons liable 25a
Prerequisites for investigation 9
Press entities 8
Remand 29
Review

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Review - Generally 19 Review - Arbitrary and capricious 20 Review - Contrary to law 21 Review by district court
Review by district court - Limitations 21a Sufficiency of notice 27
Summary proceedings 13
Time of filing 24
Time of notice 28

1. Constitutionality

Those provisions of this section, prior to the 1976 amendment of this section by Pub.L. 94-283, which vested in the Federal Election Commission primary responsibility for conducting civil litigation in the courts of the United States for vindicating public rights violated the appointments clause of the Constitution, U.S.C.A. Const. Art. 2, § 2, cl. 2; such functions may be discharged only by persons who are officers of the United States within the meaning of the clause. Buckley v. Valeo, Dist.Col.1976, 96 S.Ct. 612, 424 U.S. 1, 46 L.Ed.2d 659, motion granted 96 S.Ct. 1153, 424 U.S. 936, 47 L.Ed.2d 727, on remand 532 F.2d 187, 174 U.S.App.D.C. 300.

Federal Election Commission's petition to enforce administrative subpoena requiring defendant to appear for a deposition and produce certain documents relative to an investigation of possible illegal contributions by two national banks to defendant's 1974 Georgia gubernatorial campaign was not barred by the ex post facto and due process clauses of the Constitution, since the proscription which the banks and defendant's campaign committee were suspected of violating has been in effect since 1907, since the statutory penalties for violation of this section are civil, not quasi-criminal in nature, and since it could not be assumed that any future Commission proceeding against the subjects of the investigation would necessarily depend solely on transactions that occurred before the 1976 enactment of the Federal Corrupt Practices Act, former section 241 et seq. of this title. Federal Election Commission v. Lance, C.A.Ga.1980, 617 F.2d 365, supplemented 635 F.2d 1132, appeal dismissed, certiorari denied 101 S.Ct. 3151, 453 U.S. 917, 69 L.Ed.2d 999.

While former section 610 of Title 18 made no provision for civil damages, whereas this section now empowers the court to "impose a civil penalty" in an appropriate "civil action," such penalties are not "quasi criminal" in nature and thus are not barred by the Constitution's ex post facto clause, U.S.C.A. Const. Art. 1, § 9, cl. 3, for pre-1976 misconduct. Federal Election Commission v. Weinsten, D.C.N.Y.1978, 462 F.Supp. 243.

2. Construction with other laws

Findings concerning violations of federal election laws are governed by this section, while Commission's authority to make repayment determinations is derived from section 9007(b) of Title 26. Reagan-Bush Committee v. Federal Election Commission, D.C.D.C.1981, 525 F.Supp. 1330.

3. Mandatory nature of section

Use of word "may" in this section did not make provisions of this section permissible rather than mandatory, where Congress, which was concerned with remedy, provided for an exclusive civil remedy vested in Federal Election Commission, and then created one carefully limited exception, which provided for a "blend of administrative and judicial enforcement powers" and became available to complainant only when Commission had failed to obey directive of district court of District of Columbia. Walther v. Baucus, D.C.Mont.1979, 467 F.Supp. 93.

4. Discretion of Commission

Issue of whether a particular charge merits an investigation by the Federal Election Commission is a sensitive and complex matter calling for an evaluation of the credibility of the allegation, the nature of threat posed by offense, the resources available to agency, and numerous other factors: Congress has entrusted such matter to the discretion of the Commission and instructed the courts to interfere only when the Commission's actions are

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contrary to law. In re Federal Election Campaign Act Litigation, D.C.D.C.1979, 474 F.Supp. 1044.

5. Discretion of Attorney General

That upon request by the Federal Election Commission the Attorney General on behalf of the United States shall institute a civil action for relief does not establish that Congress intended to eliminate the discretion that has traditionally vested in the Attorney General. Buckley v. Valeo, 1975, 519 F.2d 821, 171 U.S.App.D.C. 172, affirmed in part, reversed in part on other grounds 96 S.Ct. 612, 424 U.S. 1, 46 L.Ed.2d 659.

6. Authority of Attorney General

Requirement of determination of probable cause by Federal Election Commission prior to directly referring matter without conciliation proceedings to the Attorney General does not in any manner curtail power of Attorney General to investigate and prosecute criminal violations of this chapter. U.S. v. Tonry, D.C.La.1977, 433 F.Supp. 620.

7. Conciliation agreement

Federal Election Commission's (FEC's) conciliation agreement with national political committee did not deal with regulation counting contribution against individual's per candidate limit and committee's per candidate limit if committee exercises direction and control over choice of candidate, and, thus, Commission could bring action alleging violation of regulation, even though agreement discussed Commission's settlement of the "matter" and in some contexts referred to entire series of transactions or occurrences raised by filed complaint as "matter." Federal Election Com'n v. National Republican Senatorial Committee, C.A.D.C.1992, 966 F.2d 1471.

Fact that conciliation agreement may be admitted to negate criminal intent or ameliorate sentence in a prosecution under this chapter did not require that persons violating this chapter be given opportunity to enter into conciliation agreement before criminal prosecution could be initiated, in view of provision of this section that if Commission finds probable cause to believe knowing and wilful violation has occurred, Commission may refer apparent violation to Attorney General without regard to requirement that Commission attempt conciliation. U.S. v. International Union of Operating Engineers, Local 701, C.A.Or.1979, 638 F.2d 1161, certiorari denied 100 S.Ct. 1026, 444 U.S. 1077, 62 L.Ed.2d 760.

8. Press entities

This chapter calls for a two step process when a substantial complaint is received alleging a violation of this chapter by a press entity; in first stage, until and unless press exemption is found inapplicable, Commission is barred from investigating substance of the complaint, but is permitted to investigate the two questions on which the exemption turns: whether press entity is owned by a political party or candidate and whether press entity was acting as a press entity in making distribution complained of; if Commission makes a finding of probable cause that press exemption did not apply to the circumstances, then and only then would investigation be permitted into whether a substantive violation had occurred. Reader's Digest Ass'n, Inc. v. Federal Election Commission, D.C.N.Y.1981, 509 F.Supp. 1210.

9. Prerequisites for investigation

Mere "official curiosity" will not suffice as basis for Commission investigation, since investigations may begin only if individual first files a signed, sworn, notarized complaint with Commission and Commission's duty thereafter is expeditiously to conduct confidential investigation of complaint. Federal Election Commission v. Machinists Non-Partisan Political League, 1981, 655 F.2d 380, 210 U.S.App.D.C. 267, certiorari denied 102 S.Ct. 397, 454 U.S. 897, 70 L.Ed.2d 213.

All that is required before seeking a subpoena under the Federal Election Campaign Act is that inquiry was

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proper, information sought is reasonably relevant to matter involved, and information requested be within broad scope of investigations once there had been finding of reason to believe a violation has occurred. Federal Election Com'n v. Citizens for Freeman, D.C.Md.1985, 602 F.Supp. 1250, appeal dismissed 767 F.2d 911.

10. Knowledge and willfulness

Where there was no evidence of any "knowing, conscious and deliberate flaunting" of this chapter by union in connection with its segregation of funds that could be used for direct contributions to candidates for federal elective office and those that were used for communications with union members and for nonpartisan voter registration, union considered itself to be in compliance with this chapter and routinely reported its interfund transfers to the very agency charged with enforcement of this chapter, and no decision had addressed issue whether transfers could be made from union's education fund to political contributions committee, union's violations of this chapter were not "knowing and willful" as required by subsec. (a) (6) (C) of this section upon which imposition of civil penalty against it was based. American Federation of Labor and Congress of Indus. Organizations (AFL-CIO) v. Federal Election Commission, 1980, 628 F.2d 97, 202 U.S.App.D.C. 97, certiorari denied 101 S.Ct. 397, 449 U.S. 982, 66 L.Ed.2d 244.

Despite fact that organization of professional educators violated this chapter by using "reverse check-off" system of collecting political contributions from its members, civil penalty was unwarranted, where violation was not in the nature of intentional disregard of rights of dissenting members through coercion, threats, and reprisals but was indirect infringement of those rights through excessive zeal in trying to have more efficient collection system and where expenses organization would incur in making refunds in accordance with court order would be sufficient penalty without adding fine to it. Federal Election Commission v. National Ed. Ass'n, D.C.D.C.1978, 457 F.Supp. 1102.

10A. Immunity

Associate general counsel for Federal Election Commission in charge of general counsel's enforcement section, whose responsibilities included ensuring consistent application of law in the enforcement area, was acting within outer perimeter of his official duties, and thus, was entitled to absolute immunity from liability for alleged assault and battery on paralegal specialist assigned to the enforcement section when the assistant general counsel tried to physically wrench confidential logbook from the paralegal, who, although he had authority to review contents of the logbook, was photocopying sheets from the logbook to gather evidence to controvert insubordination charges against him. Edwards v. Gross, D.D.C.1986, 633 F.Supp. 267.

11. Jurisdiction

Federal Election Commission is agency of United States government empowered with exclusive and primary jurisdiction with respect to administration, interpretation and civil enforcement of Federal Election Campaign Act of 1971, §§ 301 et seq., 306(b)(1), 307(a), 309, as amended, 2 U.S.C.A. §§ 431 et seq., 437c(b)(1), 437d(a), 437g. Federal Election Com'n v. American Intern. Demographic Services, Inc., E.D.Va.1986, 629 F.Supp. 317.

Federal Election Commission's dismissal of complaint alleging that political action committees made illegal contributions to a campaign for primary election for nomination to a congressional seat, solely based on general counsel's first report, which urged dismissal based upon a misinterpretation of the facts, was arbitrary and capricious and thus contrary to law, in that there was undisputed evidence that case involved violation of at least $2,500, and more likely $3,600. Antosh v. Federal Election Com'n, D.C.D.C.1984, 599 F.Supp. 850.

Where Commission provided defendants with notice of investigation and alleged violations involving certain expenditures, including full description of factual and legal basis for allegations, and defendants received and had fair opportunity to review and respond to Commission's findings, and yet did not express willingness to negotiate by repeatedly refusing to concede liability and respond on merits to Commission's proposals, Commission acted

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in good faith in its initiation of suit and, thus, district court had subject-matter jurisdiction over portion of action alleging violations of this chapter. Federal Election Com'n v. National Rifle Ass'n of America, D.C.D.C.1983, 553 F.Supp. 1331.

This section permitting a person aggrieved by failure of Commission to act on a complaint within 90 days of filing to challenge that failure within 60 days of 90-day period should not be read as requiring final action on all cases within that period but should be read as being jurisdictional in nature and as giving district court power after such time to decide whether failure of agency to act is contrary to law, that is, whether it is arbitrary and capricious. Common Cause v. Federal Election Commission, D.C.D.C.1980, 489 F.Supp. 738.

District court was without subject matter jurisdiction to entertain plaintiff's suit seeking enforcement of federal election laws, since primary enforcement of election laws is entrusted by section 437c of this title to Federal Election Commission, and this chapter did not permit private citizens to bring direct suits against alleged violators of the laws. In re Federal Election Campaign Act Litigation, D.C.D.C.1979, 474 F.Supp. 1051.

Where, in case in which plaintiff claimed that congressman and his election committee received excessive contributions from labor organizations for congressman's 1978 senatorial campaign in violation of this section, complaint did not allege that there had been compliance with this section and, while plaintiff's complaint was dismissed by Federal Election Commission, and while a petition for review was filed in district court for District of Columbia, there had been no decision by such court, federal district court was without jurisdiction. Walther v. Baucus, D.C.Mont.1979, 467 F.Supp. 93.

12. Complaint

Federal Elections Commission complaint launching FECA investigation was adequate even though it did not identify by name the person or entity, unknown to complainant, that was alleged to have committed identified violation of Federal Election Campaign Act and did not present complete factual and legal account of alleged violation. Federal Election Com'n v. Franklin, E.D.Va.1989, 718 F.Supp. 1272, affirmed in part, vacated in part on other grounds 902 F.2d 3.

Complaint which alleged that contributions from OPE, the political arm of the AFL-CIO and individual political action committees of various unions which exceeded a total of $5,000 were contributions made by political action committees controlled by the same group of persons, thus making the contributions excessive, which alleged that various candidates had knowingly received those assertedly illegal contributions, and which alleged that Commission had not conducted an investigation stated a claim under the provision of this section permitting private parties to bring civil actions when the Commission fails to act. Walther v. Federal Election Commission, D.C.D.C.1979, 468 F.Supp. 1235.

13. Summary proceedings

Questions of the coverage of this chapter were inappropriate in summary proceeding to enforce the Federal Election Commission's subpoena for the Florida for Kennedy Committee documents. Federal Election Commission v. Florida for Kennedy Committee, D.C.Fla.1980, 492 F.Supp. 587.

14. Disclosure

Provision of subsec. (a) (4) (B) (i) of this section that "no information derived, in connection with any conciliation attempt by the Commission * * * may be made public" did not apply to materials supplied to the Commission before the conciliation process began. Federal Election Commission v. Illinois Medical Political Action Committee, D.C.Ill.1980, 503 F.Supp. 45.

14A. Investigations

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Breach of confidentiality requirement for Federal Election Commission investigations, which resulted from one Commission employee reporting to media about credit card irregularities of presidential primary campaign, did not demonstrate bad faith on part of Commission in its investigation. Spannaus v. Federal Election Com'n, S.D.N.Y.1986, 641 F.Supp. 1520, affirmed 816 F.2d 670.

Federal Election Commission is authorized to institute investigations of possible violations of Federal Election Campaign Act of 1971, § 301 et seq., as amended, 2 U.S.C.A. § 431 et seq. Federal Election Com'n v. American Intern. Demographic Services, Inc., E.D.Va.1986, 629 F.Supp. 317.

15. Discovery

Registered voter, contending that Commission acted contrary to law in dismissing complaints containing allegations of illegal campaign contributions by various unions to members of Congress, was not entitled to require unions to appear as third parties and to be deposed in respect to contributions, where acts of unions were neither relevant nor likely to lead to relevant information in that sole issue in case concerned decision of Commission to dismiss complaints against unions, and depositions involved unwarranted intrusion into political activities of unions that might well occur or otherwise interfere with their legitimate political activity in violation of U.S.C.A. Const. Amend. 1. Walther v. Federal Election Commission, D.C.D.C.1979, 82 F.R.D. 200.

16. Exhaustion of remedies

Exhaustion of administrative remedy under this chapter was not prerequisite to indictments under this chapter, even if administrative remedy applied to alleged violations occurring in 1974 prior to effective date of amendments providing for administrative remedy. U.S. v. International Union of Operating Engineers, Local 701, C.A.Or.1979, 638 F.2d 1161, certiorari denied 100 S.Ct. 1026, 444 U.S. 1077, 62 L.Ed.2d 760.

17. Declaratory judgment and injunction

Violator did not demonstrate sort of extraordinary intransigence and hostility toward the Federal Election Commission and the Federal Election Campaign Act which would support inference that he would remain likely to violate Act for remainder of his life and, thus, permanent injunctive relief was not justified, but rather injunction should have been limited to reasonable duration. Federal Election Com'n v. Furgatch, C.A.9 (Cal.) 1989, 869 F.2d 1256.

Injunction against political committees and their treasurer, prohibiting them from future violations of conciliation agreements entered into with Federal Election Commission, was appropriate, given that defendants had failed to act diligently in the past, did not face complex litigation, and presented possibility that they could commit further violations. Federal Election Com'n v. Committee of 100 Democrats, D.D.C.1993, 844 F.Supp. 1.

Nonprofit membership corporation's challenge to application of Federal Election Commission (FEC) regulation to corporation's proposed voter guide was not yet ripe for declaratory or injunctive relief to prevent enforcement action against 1990 voter guide where advisory opinion obtained from FEC dealt with corporation's 1988 voter guide, it was possible that minor changes in wording in proposed publication could preclude necessity for enforcement action, cost of voter guides would not exceed amount that triggered Attorney General's enforcement role, and it was possible that there would be no complaints and that FEC would find no violation in revised guides. Faucher v. Federal Election Com'n, D.Me.1990, 743 F.Supp. 64, affirmed 928 F.2d 468, certiorari denied 112 S.Ct. 79, 502 U.S. 820, 116 L.Ed.2d 52.

So long as Commission was investigating limited question whether in disseminating videotape of a computer reenactment of Senator Kennedy's accident at Chappaquidick, magazine publisher was acting in context of distribution of a news story through its facilities or whether it was acting in a manner unrelated to its publishing functions, so as to determine whether press exemption in this chapter was applicable, there was no basis to grant

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injunction sought by magazine publisher to enjoin Commission from proceeding with its investigation, in that press exemption in this chapter would not protect publisher if its dissemination of the tape had nothing to do with its press function as a magazine publisher. Reader's Digest Ass'n, Inc. v. Federal Election Commission, D.C.N.Y.1981, 509 F.Supp. 1210.

Injunctive relief against violations of spending limitations of this chapter was not warranted in that it was not shown that defendants did not act in good faith to attempt to cure violations, both parties acknowledged complexity of issues and facial ambiguity of at least some of the statutory provisions in question, and there was no indication that an injunction would be necessary in order to insure future compliance with contribution limits. Federal Election Commission v. California Medical Ass'n, D.C.Cal.1980, 502 F.Supp. 196.

In action seeking declaratory and injunctive relief against the Commission, alleging that it had failed to act timely on plaintiff's June 1978 complaint, charging that certain medical organizations had made financial contributions to candidates for federally elected office in excess of the $5,000 statutory limit, and to otherwise perform its statutory obligations, the carefully qualified conditions under which certain commission materials were being made available to plaintiffs did not make them public within the meaning of this chapter. Common Cause v. Federal Election Commission, D.C.D.C.1979, 83 F.R.D. 410.

18. Civil penalty

District court could assess $25,000 civil penalty for violations of Federal Election Campaign Act, though that assessment was essentially statutory maximum for expenditures involved in violation under circumstances, in view of evidence of absence of good faith, injury to public, violator's ability to pay, and necessity of vindicating authority of the Federal Election Commission; district court was free to conclude that absence of good-faith efforts by violator to undo or cure his violations was indicative of need for larger penalty to defer future wrongdoing and of need to vindicate FEC's authority, and serious nature of violations gave rise to presumption of serious public harm. Federal Election Com'n v. Furgatch, C.A.9 (Cal.) 1989, 869 F.2d 1256.

Federal Election Commission was entitled to penalty of $1,000 for violation of conciliation agreement by political committee and its treasurer; committee and treasurer were well aware of their obligation to file disclosure reports under the law and pursuant to conciliation agreement, yet they failed to do so. Federal Election Com'n v. Committee of 100 Democrats, D.D.C.1993, 844 F.Supp. 1.

Corporation which made illegal campaign contribution would be subject to penalty measured by costs incurred by Federal Election Commission in investigating prosecuting action, where record did not indicate the corporation was chronic violator of campaign finance law which needed stiff punishment. Federal Election Com'n v. NRA Political Victory Fund, D.D.C.1991, 778 F.Supp. 62.

Fine of $3,500 and injunction were appropriate remedy upon determination that mailing list company and its founder used Federal Election Commission tapes containing names of potential contributors to political organizations for commercial purposes in violation of Federal Election Campaign Act of 1971, § 311(a)(4), as amended, 2 U.S.C.A. § 438(a)(4). Federal Election Com'n v. American Intern. Demographic Services, Inc., E.D.Va.1986, 629 F.Supp. 317.

Civil and criminal contempt citations were not imposed upon congressman's political committee or its treasurer for failure to obey default judgment directing them to file all outstanding reports required by Federal Election Campaign Act and to pay a civil penalty of $5,000, where treasurer, following entry of rule to show cause, filed all required reports and paid part of fine and proposed a schedule for the remainder, there were no underlying campaign financing improprieties or previously hidden misconduct, compliance came at great personal cost to treasurer, and treasurer's failings flowed largely from fact that he was unsophisticated in the ways of reporting under the Act. Federal Election Com'n v. Gus Savage for Congress '82 Committee, D.C.Ill.1985, 606 F.Supp. 541.

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A civil penalty of $5,000 was reasonable and appropriate and would be imposed on each defendant for exceeding contribution limit of this chapter given complex constitutional and statutory questions surrounding case. Federal Election Commission v. California Medical Ass'n, D.C.Cal.1980, 502 F.Supp. 196.

19. Review by district court--Generally

Federal Election Commission's dismissal of Federal Election Campaign Act complaint due to deadlock in voting was judicially reviewable where FEC's General Counsel had recommended, due to Commission precedent, that Commission find "reason to believe" that violation had occurred and pursue complaint. Democratic Congressional Campaign Committee v. Federal Election Com'n, 1987, 831 F.2d 1131, 265 U.S.App.D.C. 372.

In reviewing decision of Federal Election Commission on issue of whether or not to investigate a sworn complaint alleging violations of the election laws, court must test Commission's decision according to standards commonly applied to judicial review of administrative decisions requiring reversal of agency action which is either arbitrary or capricious; sensitive nature of Commission's decision calls for judicial deference to the expertise of the agency which Congress has empowered to enforce the election laws. In re Federal Election Campaign Act Litigation, D.C.D.C.1979, 474 F.Supp. 1044.

20. ---- Arbitrary and capricious

Federal Election Commission's dismissal of portion of complaint alleging that political committee violated its contribution limits and reporting obligations when it treated contributions received as result of a mass-mailing as "earmarked" was arbitrary and capricious; candidates who ultimately received contributions were not "clearly identified" in the mailings and political committee exercised some "direction or control" over contributions at issue. Common Cause v. Federal Election Com'n, D.D.C.1990, 729 F.Supp. 148.

Factors which the court may consider in determining whether a failure of the Commission to act on a complaint is arbitrary and capricious include the credibility of the allegation, the nature of the threat posed, the resources available to the agency, and the information available to it, as well as the novelty of the issues involved. Common Cause v. Federal Election Commission, D.C.D.C.1980, 489 F.Supp. 738.

Federal Election Commission was not arbitrary or capricious in its decision not to investigate complaint alleging that certain political action committees were subject to same control and should have been regarded as one political committee for purpose of statutory $5,000 contribution limitation since complaint referred Commission to wrong statute, complaint did not state that any of candidates or their committees knowingly accepted donations from separate political action committees which were subject to the same control and did not present evidence that accused parties possessed knowledge of the illicit control, and since complaint, even when it stated valid charge, did so only in the most conclusory fashion. In re Federal Election Campaign Act Litigation, D.C.D.C.1979, 474 F.Supp. 1044.

21. ---- Contrary to law

In determining whether Commission's interpretation of section 441a of this title was contrary to law, task for court is not to interpret such provision as it thinks best, but rather a narrower inquiry into whether Commission's construction is sufficiently reasonable to be accepted by reviewing court; to satisfy this standard it is not necessary for court to find that agency's construction was the only reasonable one or even the reading the court would have reached if question had initially arisen in judicial proceeding. Federal Election Commission v. Democratic Senatorial Campaign Committee, Dist.Col.1981, 102 S.Ct. 38, 454 U.S. 27, 70 L.Ed.2d 23.

Federal Election Commission's decision is contrary to law if FEC has dismissed complaint as result of impermissible interpretation of law or if dismissal under permissible interpretation of law was arbitrary or capricious or abuse of discretion. Orloski v. Federal Election Com'n, 1986, 795 F.2d 156, 254 U.S.App.D.C. 111.

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Judicial review of Federal Election Commission's decision not to investigate a complaint is deferential; court is to reverse agency only if agency's decision is contrary to law. Democratic Senatorial Campaign Committee v. Federal Election Com'n, D.D.C.1990, 745 F.Supp. 742.

Commissioners' statement of reasons for preventing, by voting to deadlock, Federal Election Commission action on complaint that candidate and political action committee violated Federal Election Campaign Act was "sufficiently reasonable"; statement of reasons cited, inter alia, unequivocal denials by candidate and political action committee that they had collaborated in such fashion as to deprive political action committee's financial support of candidacy of its character as "independent expenditures," and disagreement with advisory opinion which served as basis for General Counsel's determining that political action committee's providing preaddressed envelopes in which contributions could be directly mailed to candidate and verified by "pledge card" was in-kind contribution. Stark v. Federal Election Com'n, D.D.C.1988, 683 F.Supp. 836.

Given extreme sensitivity of political expression and electoral process, failure of Federal Election Commission to pursue congressman's complaint expeditiously at all times in its handling of complaint weighed in favor of determination that delay in acting on complaint on or before eve of next congressional election was contrary to law. Rose v. Federal Election Com'n, D.C.D.C.1984, 608 F.Supp. 1.

Conduct of investigation by Commission into complaints of alleged violations of this chapter by an association and several of its state political action committees, and conciliation agreements which Commission entered into with association and its committees, were not contrary to law where, though time consumed by investigation was of an inordinate length, agreements resolved all but arguably one of the violations alleged by statutorily preferred method. Common Cause v. Federal Election Commission, D.C.D.C.1980, 489 F.Supp. 738.

21A. ---- Limitations

Sixty-day period for filing petition for review of Federal Election Commission decision to dismiss administrative complaint filed by treasurer of election campaign began to run on date of dismissal, rather than on later date on which treasurer actually received notice of dismissal. Spannaus v. Federal Election Com'n, C.A.D.C.1993, 990 F.2d 643.

Sixty-day limitations period for filing petitions for review of Federal Election Commission orders is jurisdictional and unalterable and cannot be circumvented by procedural devices; in particular, party who has failed to file for review within prescribed limitations period cannot obtain new filing period by simple expedient of filing new request for the same agency action. National Rifle Ass'n of America v. Federal Election Com'n, 1988, 854 F.2d 1330, 272 U.S.App.D.C. 121.

The 60-day period for seeking review of decision of Federal Election Commission dismissing an administrative complaint was not measured with reference to date on which Commission unanimously voted to accept conciliation agreements and close the file but, rather, from date on which the Commission approved the agreements and they became effective. Antosh v. Federal Election Com'n, D.C.D.C.1985, 613 F.Supp. 729.

22. Appellate review

District court's exercise of its discretionary authority in imposition of civil penalties under this chapter must be guided by sound legal principles and is subject to appellate review. American Federation of Labor and Congress of Indus. Organizations (AFL-CIO) v. Federal Election Commission, 1980, 628 F.2d 97, 202 U.S.App.D.C. 97, certiorari denied 101 S.Ct. 397, 449 U.S. 982, 66 L.Ed.2d 244.

23. Expeditious handling of complaint

The Federal Election Commission's handling of congressman's administrative complaint charging violations of the Federal Election Campaign Act and its position in congressman's subsequent litigation to compel FEC action

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were substantially justified and, therefore, FEC was not liable to congressman under the Equal Access to Justice Act, notwithstanding district court's granting summary judgment in favor of congressman on merits; FEC's attention to congressman's complaint was prompt and sustained, and FEC had no practical alternative to defending against congressman's suit to compel action due to congressman's advancing incorrect interpretation of FECA. Federal Election Com'n v. Rose, 1986, 806 F.2d 1081, 256 U.S.App.D.C. 395.

Federal Election Commission did not comply with statutory indication of speed with which it was required to act on congressman's complaint alleging unlawful practices during 1982 congressional campaign where Commission consumed approximately 172 days before it filed statement that it had "reason to believe" that violations had occurred and Commission allowed discovery to delay 1982 congressional election matter until it was competing with new 1984 election priorities. Rose v. Federal Election Com'n, D.C.D.C.1984, 608 F.Supp. 1.

24. Time of filing

Federal Election Commission's interpretation of statute [Federal Election Campaign Act of 1971, § 309(a)(8)(B), as amended, 2 U.S.C.A. § 437g(a)(8)(B)] which measures period of filing petition for judicial review of Commission's dismissal of administrative complaint from "date of the dismissal," a procedural rather than substantive provision, deserved no special deference from district court. Common Cause v. Federal Election Com'n, D.D.C.1985, 630 F.Supp. 508.

25. Persons entitled to maintain action

Citizen who lived, worked and voted in Oklahoma lacked standing to contest failure of Federal Election Commission to act favorably upon his administrative complaint of political fund-raising improprieties in connection with reelection campaign of United States senator from Arizona. Antosh v. Federal Election Com'n, D.D.C.1986, 631 F.Supp. 596.

25A. Persons liable

Treasurer of political committees, as party to conciliation agreements settling violations of Federal Election Campaign Act, was personally liable for violation of such agreements. Federal Election Com'n v. Committee of 100 Democrats, D.D.C.1993, 844 F.Supp. 1.

26. Notice and opportunity for hearing

Federal Election Commission's determination that there had been no violation of Federal Election Campaign Act by corporate donations to picnic sponsored by congressman was not procedurally defective because of failure of FEC to give challenger opportunity to reply to challenged candidate's response to challenger's allegations. Orloski v. Federal Election Com'n, 1986, 795 F.2d 156, 254 U.S.App.D.C. 111.

Federal Elections Commission's inability to directly notify unknown respondent did not divest Commission of subject matter jurisdiction over investigation of Federal Election Campaign Act violation alleged in complaint on which Commission made reason to believe determination; Commission invited notice and opportunity to respond through attorney/private investigator hired by respondent, and there was no showing or suggestion of bad faith on part of Commission in launching investigation. Federal Election Com'n v. Franklin, E.D.Va.1989, 718 F.Supp. 1272, affirmed in part, vacated in part on other grounds 902 F.2d 3.

27. Sufficiency of notice

Letter by Federal Election Commission, which was sent to campaign committee for presidential primary and treasurer, which set forth sections of Federal Election Campaign Act and Presidential Primary Matching Payment Account Act that allegedly were violated, and which contained summary of factual allegations, satisfied

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Commission's obligation to notify campaign committee and treasurer regarding investigation of campaign. Spannaus v. Federal Election Com'n, S.D.N.Y.1986, 641 F.Supp. 1520, affirmed 816 F.2d 670.

28. Time of notice

Federal Election Commission was not required to notify campaign committee of presidential primary candidate that it sent questionnaires to some contributors to campaign committee, but was required to notify candidate only after Commission had made finding that there was reason to believe in existence of violation of Federal Election Campaign Act. Spannaus v. Federal Election Com'n, S.D.N.Y.1986, 641 F.Supp. 1520, affirmed 816 F.2d 670.

29. Remand

District court should have remanded, rather than deciding on merits, Federal Election Campaign Act complaint which Federal Election Commission dismissed in spite of FEC's General Counsel's contrary recommendation; while FEC was sending "conflicting messages" and appeared to be acting with an uneven hand when it dismissed complaint without explanation while leaving undisturbed apparently contradictory precedent, the Commission was entitled to a further opportunity to set its precedent in order so that it, and not a court of review, would serve as primary decision maker. Democratic Congressional Campaign Committee v. Federal Election Com'n, C.A.D.C.1987, 831 F.2d 1131.

2 U.S.C.A. § 437g

2 USCA § 437g

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DATE AND TIME PRINTING STARTED:	05/23/95	10:45:09 am (Central)
DATE AND TIME PRINTING ENDED:	05/23/95	10:46:35 am (Central)
OFFLINE TRANSMISSION TIME:		00:01:26
NUMBER OF REQUESTS IN GROUP:	1	
NUMBER OF LINES CHARGED:	928	

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18 USC § 20 (esp (1) (A) (i))

PART E—RECEIPT OF STOLEN BANK PROPERTY

1. In general and present Federal law

This Part of title XI is designed to remedy a flaw in current 18 U.S.C. 2113(c). That statute punishes whoever receives, possesses, conceals, sells, or disposes of any property "knowing the same to have been taken from a bank, credit union, or any savings and loan association" in violation of the preceding subsection which proscribes theft from such financial institutions. The problem is that, in requiring knowledge that the property was taken "from a bank" or other federally insured institution, the section is unduly generous to wrongdoers. It does not permit a successful prosecution in cases in which the proof is overwhelming that the defendant acted culpably in that he possessed property he knew had been stolen but where no evidence exists to show that he knew it had been stolen "from a bank". Normally, it should not be necessary to prove scienter as to what is essentially a jurisdictional fact—here, that the property was stolen from a bank; and the inclusion of this gratuitous element in section 2113(c) has occasionally resulted in the unwarranted exoneration of the knowing receivers of stolen property.[1]

2. Provisions of the bill, as reported

Part E rewrites 18 U.S.C. 2113(c) making only one substantive change. In place of the existing requirement of knowledge that property was taken "from a bank", the bill requires only proof of knowledge that the property "has been stolen". Thus, it closes the loophole under which certain knowing receivers of property stolen from a bank have escaped conviction.

[1] See, e.g., *United States* v. *Kaplan*, 586 F.2d 980 (2d Cir. 1978); *United States* v. *Tavoularis*, 515 F.2d 1070 (2d Cir. 1975).

PART F—BANK BRIBERY

1. In general

This part revises and modernizes the statutory law dealing with bribery of bank officers. Sections 215 and 216 of title 18 presently cover the receipt of commissions or gifts by bank employees for procuring loans, but they are inadequate, unduly complex, and obsolete in many respects. For example, these sections do not reach bribery of employees of federally insured credit unions, or member banks of the Federal Home Loan Bank System, such as savings and loan associations, or of bank holding companies. The bill combines existing sections 215 and 216 to bring up to date the list of covered institutions and to make other improvements, including the prohibition of indirect as well as direct payments and an increase in applicable penalties. The proposal was contained in S. 1630, the Criminal Code reform bill approved by the committee last Congress,[1] and derives from legislation introduced a decade ago.[2]

2. Present Federal law

As noted, the commercial bribery aspects of Federal regulation of the banking industry are currently covered in 18 U.S.C. 215 and 216.

Under 18 U.S.C. 215, the officers, employees, and agents of banks the deposits of which are insured by the Federal Deposit Insurance Corporation, as well as certain other specified financial institutions,[3] are prohibited from stipulating for, receiving, or agreeing to receive anything of value from any person, firm, or corporation "for procuring or endeavoring to procure," for the giver or for anyone else, "any loan or extension or renewal of loan or substitution of security, or the purchase or discount or acceptance of any paper, note, draft, check, or bill of exchange by" any such bank or financial institution. The penalty is imprisonment for up to one year.

Significantly, this statute does not reach the bribe offeror, but only the recipient of the bribe, although the offering party can be punished by means of the aiding and abetting or conspiracy statutes. This statute has been held to punish receipt of a gift for procuring a loan even though the loan was completed before the gift or fee was received.[4] Because of the inclusion of the term "stipulates for," it has also been construed to proscribe the action of a bank officer who stipulated that a commission for obtaining loan from the bank be paid to a third party. The court found that Con-

[1] See S. Rept. No. 97-307, pp. 796-797.
[2] H.R. 6531 and S. 1428, 93rd Cong., 1st Sess. (1973).
[3] The other specified institutions are a "Federal intermediate credit bank" and a National Agricultural Credit Corporation.
[4] See *Ryan* v. *United States*, 278 F.2d 836 (9th Cir. 1960).

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 60

gress' purpose under this statute was to protect the deposits of Federally insured banks by preventing unsound and improvident loans to be made from such banks and that it was thus immaterial who received the commission.[5]

18 U.S.C. 216 is a somewhat broader statute that reaches payments made to employees and officials of Federal land bank institutions and small business investment companies. It punishes by up to one year in prison whoever, being an employee or official of the type described above, "is a beneficiary of or receives any fee * * * or other consideration for or in connection with any transaction or business of such association or bank, other than the usual salary or director's fee paid to such officer—or employee for services rendered." This statute also penalizes whoever causes or procures a Federal land bank institution or small business investment company to charge or receive any consideration not specifically authorized.

Experience under this statutory scheme has led to the conclusion that the above laws are inadequate and obsolete because they neither cover all of the individuals or institutions that should be covered nor all of the activities that should be illegal. As a result the Committee has endorsed the instant legislation that would combine 18 U.S.C. 215 and 216 into a single statute, punishing both bribe offerors or givers and bribe recipients, and expanding the institutions covered to include every financial institution the transactions of which the Federal Government has a substantial interest in protecting against undue influence by bribery (e.g., in addition to those presently covered under 18 U.S.C. 215 and 216, any member of the Federal Home Loan Bank System and any Federal Home Loan Bank; any institution the deposits of which are insured by the Federal Savings and Loan Insurance Corporation; any credit union the deposits of which are insured under the Federal Credit Union Act of 1934, as amended, etc.).

3. Provisions of the bill, as reported

Part F rewrites 18 U.S.C. 215 and repeals 18 U.S.C. 216. New section 215(a) is recast broadly to prohibit whoever, being an officer, director, employee, agent, or attorney of any financial institution, bank holding company, or savings and loan holding company, directly or indirectly asks, demands, exacts, solicits, seeks, accepts, receives, or agrees to receive anything of value, for himself or any other person other than such financial institution, from any person for or in connection with any transaction or business of such financial institution. The phrase "in connection with any transaction," etc. adopts the comprehensive style of current 18 U.S.C. 216 rather than the narrower method used in present 18 U.S.C. 215 to list the specific kinds of transactions reached. Also, the new section clearly proscribes the receipt of anything of value for a third person, thus carrying forward the interpretation in the *Lane* case, *supra*. Subsection (c) defines the terms "financial institution," "bank holding company" and "savings and loan holding company" to include all the types of federal financial institutions as to which there exists a strong federal interest to safeguard the transactions against undue

[5] See *United States* v. *Lane*, 464 F.2d 593 (8th Cir.), cert. denied, 409 U.S. 876 (1972).

influence by bribery. Subsection (b) proscribes activities of the same scope as subsection (a), but with respect to the bribe offeror or giver rather than the bribe taker or solicitor. Subsection (d), like present 18 U.S.C. 216, includes an explicit exemption for payments by the financial institution of the usual salary or director's fee paid to an officer, director, employee, agent, or attorney thereof, or for a reasonable fee paid by the financial institution to such persons for services rendered.

The penalty for a violation of subsection (a) or (b) is up to five years in prison and a fine of $5,000 or three times the value of the bribe offered, asked, given, received, or agreed to be given or received, whichever is greater, except that if such value is $100 or less the offense is punishable by up to one year in prison and a $1,000 fine. This grading has the effect generally of increasing the level of the kind of offenses now covered by 18 U.S.C. 215 and 216 from a misdemeanor to a felony. The Committee considers this increase justified in recognition of the strong Federal interest in deterring such crimes as they affect the banking industry and in view of the seriously culpable nature of the conduct involved. Notably, violations of other analogous statutes, such as 41 U.S.C. 54 proscribing commercial bribery with regard to government contractors, carry felony penalties. An exception from felony treatment is, however, provided for an offense where the bribe is relatively insignificant in amount and thus is less likely to have affected the recipient's conduct.

[page 377]

PART G—BANK FRAUD

1. In general and present Federal law

The offense of bank fraud in this part is designed to provide an effective vehicle for the prosecution of frauds in which the victims are financial institutions that are federally created, controlled or insured.

Recent Supreme Court decisions have underscored the fact that serious gaps now exist in Federal jurisdiction over frauds against banks and other credit institutions which are organized or operating under Federal law or whose deposits are federally insured. Clearly, there is a strong Federal interest in protecting the financial integrity of these institutions, and the legislation in this part would assure a basis for Federal prosecution of those who victimize these banks through fraudulent schemes.

The need for Federal jurisdiction over crimes committed against federally insured and controlled financial institutions has been recognized by the Congress in its passage of statutes specifically reaching crimes of embezzlement, robbery, larceny, burglary, and false statement directed at these banks. However, there is presently no similar statute generally proscribing bank fraud. As a result, Federal prosecutions of these frauds may now be pursued only if the circumstances of a particular fraud are such that the elements of some other Federal offense are met. Thus, whether Federal inter-

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 61

ests may be properly vindicated through prosecution turns on whether the fraudulent activity constitutes a crime under some other bank statutes, such as those governing larceny or false statement (18 U.S.C. 2113 and 1014), or whether the fradulent scheme involves a use of the mails or telecommunications that would permit prosecution under the mail or wire fraud statutes (18 U.S.C. 1341 and 1343).

This approach of prosecuting bank fraud under statutes not specifically designed to reach this criminal conduct is necessarily problematic. Nonetheless, for some time the Department of Justice had considerable success in using such statutes. The most useful of these was the mail fraud offense, for not only had the statute been held to reach a wide range of fraudulent activity, but also its jurisdictional element—use of the mails—could generally be satisfied in bank fraud cases because the collection procedures of victim banks ordinarily entailed use of the mails. In 1974, however, the utility of the mail fraud statute was notably diminished by the Supreme Court decisions in *United States* v. *Maze.*[1] In *Maze,* the Court held that proof that use of the mails occurred in or was caused by a fradulent scheme was insufficient for conviction under the mail fraud statute. Instead, proof that use of the mails played a significant

[page 378]

part in bringing the scheme to fruition would be required. In addition to the problems of proof posed by the *Maze* decision, banks' increasing use of private courier services for collection purposes in lieu of the mails has further limited the instances in which the mail fraud statute may be used to prosecute bank fraud.

The use of other Federal statutes to attack bank fraud as an alternative to prosecution under the mail fraud offense has also been circumscribed by recent court decisions. By virtue of the Supreme Court's decision last year in *Williams* v. *United States,*[2] the bank false statement offense, 18 U.S.C. 1014, may no longer be applied to address one of the most pervasive forms of bank fraud, check-kiting. In *Williams,* the Court concluded this form of fraud did not fall within the scope of 18 U.S.C. 1014 because a check did not constitute a "statement" within the meaning of the statute. As a result of this decision, the Committee has been advised by the Justice Department that it has been necessary to cease prosecution of numerous pending check-kiting cases. Similarly, there appears to be an absence of coverage with respect to some types of fraud in the general bank theft statute, 18 U.S.C. 2113. Although the Supreme Court recently held that section 2113 is not limited to common law larceny and reaches also certain offenses involving the obtaining of property from banks by false pretenses,[3] the Court noted that, by its clear terms, section 2113 "does not apply to a case of false pretenses in which there is not a taking and carrying away" of the property. These various gaps in existing statutes, as well as the lack of a unitary provision aimed directly at the problem of bank fraud, in the Committee's view create a plain need for

[1] 414 U.S. 395 (1974).
[2] 102 S. Ct. 2088 (1982).
[3] *Bell* v. *United States,* — U.S. — (decided June 13, 1983).

enactment of the general bank fraud statute set forth in this part of title XI.

2. Provisions of the bill, as reported

Part G would create a new section 1344 of title 18, United States Code. Subsection (a) prohibits whoever knowingly executes, or attempts to execute, a scheme or artifice (1) to defraud a federally chartered or insured financial institution, or (2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by or under the custody or control of a federally chartered or insured financial institution by means of false or fraudulent pretenses, representations, or promises. The penalty for a violation is imprisonment of up to five years and a fine of $10,000.

The proposed bank fraud statute is modeled on the present wire and mail fraud statutes which have been construed by the courts to reach a wide range of fraudulent activity. Like these existing fraud statutes, the proposed bank fraud offense proscribes the conduct of executing or attempting to execute "a scheme or artifice to defraud" or to take the property of another "by means of false or fraudulent pretenses, representations, or promises." While the basis for Federal jurisdiction in these existing general fraud statutes is the use of the mails or wire communications, in the proposed offense, jurisdiction is based on the fact that the victim of the offense is a federally controlled or insured institution defined

[page 379]

as a "federally chartered or insured financial institution" in subsection (b) of the proposal. This term is defined to include all financial institutions whose deposits or accounts are insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, or the Administrator of the National Credit Union Administration, Federal home loan banks or member banks of the Federal home loan bank system, and any banks or other financial institutions organized or operating under the laws of the United States.

Since the use of bogus or "shell" offshore banks has increasingly become a means of perpetrating major frauds on domestic banks and the considerable delay in collections between domestic and foreign banks makes manipulation of foreign financial transactions an attractive mode of defrauding banks within the United States, it is intended that there exist extraterritorial jurisdiction over the offense. This means that even if the conduct constituting the offense occurs outside the United States, once the offender is present within the country, he may nonetheless be subject to Federal prosecution.

In sum, the scope of present Federal statutes is not sufficient to assure effective prosecution of the range of fraudulent crimes commonly committed today against federally controlled or insured financial institutions. The legislative proposal contained in this part would meet the need for a statutory basis for asserting Federal jurisdiction over such offenses and would thereby better assure the integrity of the Federal banking system.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 62

that has been furnished to the grand jury in response to that subpoena, shall be fined under this title or imprisoned not more than 5 years, or both.

"(2) Whoever, being an officer of a financial institution, directly or indirectly notifies—

"(A) a customer of that financial institution whose records are sought by a grand jury subpoena; or

"(B) any other person named in that subpoena;

about the existence or contents of that subpoena or information that has been furnished to the grand jury in response to that subpoena, shall be fined under this title or imprisoned not more than one year, or both.

"(3) As used in this subsection—

"(A) the term 'an officer of a financial institution' means an officer, director, partner, employee, agent, or attorney of or for a financial institution; and

"(B) the term 'subpoena for records' means a Federal grand jury subpoena for customer records that has been served relating to a violation of, or a conspiracy to violate—

"(i) section 215, 656, 657, 1005, 1006, 1007, 1014, or 1344; or

"(ii) section 1341 or 1343 affecting a financial institution.".

(d) CONFORMING TERMINOLOGY IN BANK ROBBERY SECTION.—Section 2113 of title 18, United States Code, is amended—

(1) in subsection (f), by striking "any bank the deposits of which" and inserting "any institution the deposits of which";

(2) by adding before the period at the end of subsection (h) ", and any 'Federal credit union' as defined in section 2 of the Federal Credit Union Act"; and

(3) by striking subsection (g) and redesignating subsection (h) as subsection (g).

(e) CREATION OF GENERAL DEFINITION OF FINANCIAL INSTITUTION FOR TITLE 18.—

(1) IN GENERAL.—Subsection (b) of section 215 of title 18, United States Code, is transferred to the end of chapter 1 of such title.

(2) UPDATING AND TECHNICAL AMENDMENTS.—Such subsection (b), as so transferred, is amended—

(A) by inserting at the beginning the following section heading:

"§ 20. Financial institution defined"

(B) by striking "(b)";

(C) by striking "this section" and inserting "this title";

(D) so that paragraph (1) reads as follows:

"(1) an insured depository institution (as defined in section 3(c)(2) of the Federal Deposit Insurance Act);";

(E) by striking paragraphs (2) and (8);

(F) so that paragraph (5) reads as follows:

"(5) a System institution of the Farm Credit System, as defined in section 5.35(3) of the Farm Credit Act of 1971;";

(G) so that paragraph (7) reads as follows:

"(7) a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act.";

and

A # 57720 (URTS 16326) DocId: 70105318 Page 63

(H) by redesignating paragraphs (3), (4), (5), (6), and (7) (as amended by this paragraph) as paragraphs (2), (3), (4), (5), and (6), respectively.

(3) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 1 of title 18, United States Code, is amended by adding at the end the following new item:

"20. Financial institution defined.".

SEC. 963. CIVIL AND CRIMINAL FORFEITURE.

(a) CIVIL FORFEITURE.—Section 981(a)(1) of title 18, United States Code, is amended by adding at the end the following:

Real property.

"(C) Any property, real or personal, which constitutes or is derived from proceeds traceable to a violation of section 215, 656, 657, 1005, 1006, 1007, 1014, or 1344 of this title.".

(b) TRANSFER OF PROPERTY UNDER CIVIL FORFEITURE.—Section 981(e) of title 18, United States Code, is amended—

(1) in the matter before paragraph (1), by striking out "determine to—" and inserting in lieu thereof "determine—";

(2) by striking out paragraphs (1) and (2) and inserting in lieu thereof the following:

"(1) to any other Federal agency;

"(2) to any State or local law enforcement agency which participated directly in any of the acts which led to the seizure or forfeiture of the property;

"(3) in the case of property referred to in subsection (a)(1)(C) (if the affected financial institution is in receivership or liquidation), to any Federal financial institution regulatory agency—

"(A) to reimburse the agency for payments to claimants or creditors of the institution; and

"(B) to reimburse the insurance fund of the agency for losses suffered by the fund as a result of the receivership or liquidation;

"(4) in the case of property referred to in subsection (a)(1)(C) (if the affected financial institution is not in receivership or liquidation), upon the order of the appropriate Federal financial institution regulatory agency, to the financial institution as restitution, with the value of the property so transferred to be set off against any amount later recovered by the financial institution as compensatory damages in any State or Federal proceeding; or

"(5) in the case of property referred to in subsection (a)(1)(C), to any Federal financial institution regulatory agency, to the extent of the agency's contribution of resources to, or expenses involved in, the seizure and forfeiture, and the investigation leading directly to the seizure and forfeiture, of such property."; and

(3) by adding at the end the following new sentence: "The United States shall not be liable in any action arising out of a transfer under paragraph (3), (4), or (5) of this subsection.".

(c) CRIMINAL FORFEITURE.—Section 982 of title 18, United States Code, is amended—

(1) in subsection (a)—

(A) by inserting "(1)" after "(a)"; and

(B) by adding at the end the following:

"(2) The court, in imposing sentence on a person convicted of a violation of, or a conspiracy to violate, section 215, 656, 657, 1005, 1006, 1007, 1014, 1341, 1343, or 1344 of this title, affecting a financial

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 64

imprisonment for 5 years and a $10,000 fine, although 18 U.S.C. 3571 authorizes the court to impose a fine higher than $5,000.[11]

Section 961(k)(2) makes technical and conforming changes. Section 961(l)(1) adds a new section (3293) to chapter 213 of title 18 of the U.S. Code to provide a 10-year statute of limitations for banking offenses. The present statute of limitations period is five years.[12] New section 3293 applies the ten year statute of limitations to (1) a violation of 18 U.S.C. 215 (financial institution bribery), 656 and 657 (financial institution misapplication and embezzlement), 1005 and 1006 (false entries in reports on financial institutions), 1007 (fraud on deposit insurers), 1014 (false statement or overvaluation), and 1344 (financial institution fraud); (2) a violation of 18 U.S.C. 1341 or 1343 (mail and wire fraud) if the violation affects a financial institution; and (3) a conspiracy to violate any of these sections. Section 962(l)(2) makes necessary conforming changes. Section 961(l)(3) provides that the 10-year period applies to all offenses committed before the enactment of this legislation, as long as the five year statute has not already expired.

Section 961(m) amends 28 U.S.C. 994(p) and section 21 of the Sentencing Act of 1987, which authorize the United States Sentencing Commission to promulgate and amend sentencing guidelines. Section 961(m)(1) directs the Sentencing Commission to assign to a serious banking related offense an offense level of at least a 24. Section 961(m)(2) provides that section 961 applies to violations or a conspiracy to violate 18 U.S.C. 215 (financial institution bribery), 656 and 657 (financial institution misapplication and embezzlement), 1005 and 1006 (false entries in reports on financial institutions), 1007 (fraud on deposit insurers), 1014 (false statement or overvaluation), 1341 or 1343 (mail and wire fraud if the violation affects a financial institution), and 1344 (financial institution fraud) where such offense substantially jeopardizes the safety and soundness of a financial institution. Section 961(m)(3) provides that the requirements of section 961 shall expire on December 31, 1993.

SEC. 962. MISCELLANEOUS REVISIONS TO TITLE 18.

Section 962 makes miscellaneous amendments to title 18 of the U. S. Code. Section 962(a) amends title 18 to replace the term "Federal Home Loan Bank Board" with the term "Office of Thrift Supervision".

Section 962(b)(1) broadens 18 U.S.C. 212, which deals with offers of loans or gratuities to bank examiners, to cover financial institutions and the Office of Thrift Supervision examiners, as well as "banks". Section 962(b)(2) expands 18 U.S.C. 213, which deals with acceptance of loans or gratuities by bank examiners, to include financial institutions other than banks. Section 962(b)(3) repeals 18 U.S.C. 1009. Section 962(b)(4), (5), and (6) and section 962(c) make technical and clerical amendments.

Section 962(d) amends 18 U.S.C. 1510, which deals with obstructing a criminal investigation. Section 962(d) expands 18 U.S.C. 1510, to make it an offense for an officer, director, partner, employee, or attorney of a financial institution knowingly to notify certain per-

[11] See n.2 *supra*.
[12] See n.2 *supra*.

sons that a grand jury has subpoenaed the records of a customer, in connection with the investigation of the possible banking offenses listed in 951(c). The persons to whom disclosure is prohibited are (1) the customer whose records are sought, or (2) a target of the grand jury investigation. The maximum penalty is 5 years imprisonment and a fine under title 18 of the United States Code.[13]

Section 962(e) makes conforming amendments to 18 U.S.C. 2113. Section 962(f) makes technical amendments to 18 U.S.C. 215 and makes the definition of "financial institution" set forth in 18 U.S.C. 215(b) applicable to all of title 18, by moving the definition into a separate section (20) of title 18 of the United States Code.

SEC. 963. CIVIL AND CRIMINAL FORFEITURE.

Section 963 provides for civil and criminal forfeiture in connection with title 18 offenses affecting financial institutions. Section 963(a) amends 18 U.S.C. 981, which deals with civil forfeiture. Section 963(a)(1) provides for civil forfeiture for (1) a violation of 18 U.S.C. 215, 656, 657, 1005, 1006, 1007, 1014, or 1344; (2) a violation of 18 U.S.C. 1341 or 1343 affecting a financial institution; and (3) conspiracy to violate any of the above sections. Section 963(a)(2) makes necessary conforming changes and authorizes the Attorney General to sell any forfeited property which is not required to be destroyed or is not harmful. Section 963(a)(2) also adds a new provision establishing a priority for the disposition of proceeds that have been civilly forfeited. First, proceeds are used to reimburse out-of-pocket expenses incurred for seizure and forfeiture by the Federal banking agency regulating the financial institution. Second, proceeds go to the Department of Justice to reimburse its out-of-pocket expenses for seizure and forfeiture. Third, if the affected financial institution is in receivership or liquidation, proceeds go to a Federal banking agency regulating the institution, to reimburse the agency for (i) payments to claimants or creditors or (ii) losses suffered by that agency's insurance fund as a result of the receivership or liquidation. Fourth, if the affected financial institution is not in receivership or liquidation, the proceeds go to the General Fund of the Treasury or, upon the order of the appropriate Federal bank regulatory agency, to the affected financial institution as restitution. Amounts received by the financial institution shall be set off against amounts later recovered by the institution as compensatory damages in a State or Federal proceeding.

Section 963(b) amends 18 U.S.C. 982, which deals with criminal forfeiture. Section 963(b)(1) authorizes criminal forfeiture for (1) a violation of 18 U.S.C. 215, 656, 657, 1005, 1006, 1007, 1014, or 1344; (2) a violation of 18 U.S.C. 1341 or 1343 affecting a financial institution; and (3) a conspiracy to violate any of those sections. Section 963(b)(2) provides that property forfeited for these violations shall be disposed of in accordance with the Comprehensive Drug Abuse Prevention and Control Act of 1970 (12 U.S.C. 853).

[13] Under 18 U.S.C. 3571, the court can impose a fine (1) for an organization, of up to the greater of $500,000 or twice the amount gained or the loss inflicted by the offense for an organization; (2) for an individual, up to the greater of $250,000 or twice the amount gained or the loss inflicted by the offense.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 66

BANK BRIBERY AMENDMENTS ACT OF 1985

For Legislative History of Act see Report for P.L. 99–370 in Legislative History Section, post.

An Act to amend title 18, United States Code, with respect to certain bribery and related offenses.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Bank Bribery Amendments Act of 1985.
18 USC 201 note.

SECTION 1. SHORT TITLE.

This Act may be cited as the "Bank Bribery Amendments Act of 1985".

SEC. 2. CHAPTER 11 AMENDMENT.

Section 215 of title 18, United States Code, is amended to read as follows:

"§ 215. Receipt of commissions or gifts for procuring loans

Law enforcement and crime.

"(a) Whoever—

"(1) corruptly gives, offers, or promises anything of value to any person, with intent to influence or reward an officer, director, employee, agent, or attorney of a financial institution in connection with any business or transaction of such institution; or

"(2) as an officer, director, employee, agent, or attorney of a financial institution, corruptly solicits or demands for the benefit of any person, or corruptly accepts or agrees to accept, anything of value from any person, intending to be influenced or rewarded in connection with any business or transaction of such institution;

shall be fined not more than $5,000 or three times the value of the thing given, offered, promised, solicited, demanded, accepted, or agreed to be accepted, whichever is greater, or imprisoned not more than five years, or both, but if the value of the thing given, offered, promised, solicited, demanded, accepted, or agreed to be accepted does not exceed $100, shall be fined not more than $1,000 or imprisoned not more than one year, or both.

"(b) As used in this section, the term 'financial institution' means—

"(1) a bank with deposits insured by the Federal Deposit Insurance Corporation;

"(2) an institution with accounts insured by the Federal Savings and Loan Insurance Corporation;

"(3) a credit union with accounts insured by the National Credit Union Share Insurance Fund;

"(4) a Federal home loan bank or a member, as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422), of the Federal home loan bank system;

"(5) a Federal land bank, Federal intermediate credit bank, bank for cooperatives, production credit association, and Federal land bank association;

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 67

"(6) a small business investment company, as defined in section 103 of the Small Business Investment Act of 1958 (15 U.S.C. 662);

"(7) a bank holding company as defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841); or

"(8) a savings and loan holding company as defined in section 408 of the National Housing Act (12 U.S.C. 1730a).

"(c) This section shall not apply to bona fide salary, wages, fees, or other compensation paid, or expenses paid or reimbursed, in the usual course of business.

"(d) Federal agencies with responsibility for regulating a financial institution shall jointly establish such guidelines as are appropriate to assist an officer, director, employee, agent, or attorney of a financial institution to comply with this section. Such agencies shall make such guidelines available to the public.".

Public information.

18 USC 215 note.

SEC. 3. EFFECTIVE DATE.

This Act and the amendments made by this Act shall take effect 30 days after the date of the enactment of this Act.

Approved August 4, 1986.

LEGISLATIVE HISTORY—H.R. 3511:

HOUSE REPORTS: No. 99-335 (Comm. on the Judiciary).
CONGRESSIONAL RECORD:
Vol. 131 (1985): Oct. 29, considered and passed House.
Vol. 132 (1986): Feb. 4, considered and passed Senate, amended.
Apr. 22, House concurred in Senate amendments, in another with an amendment.
June 24, Senate concurred in House amendment with an amendment.
June 26, House concurred in Senate amendment.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 68

PUBLIC LAW 98-473 [H.J.Res. 648]; October 12, 1984

CONTINUING APPROPRIATIONS, 1985—COMPREHENSIVE CRIME CONTROL ACT OF 1984

For Legislative History of Act, see p. 3182

Joint Resolution making continuing appropriations for the fiscal year 1985, and for other purposes.

TITLE I

That the following sums are hereby appropriated, out of any money in the Treasury not otherwise appropriated, and out of applicable corporate or other revenues, receipts, and funds, for the several departments, agencies, corporations, and other organizational units of the Government for the fiscal year 1985, and for other purposes, namely:

Agriculture, rural development appropriations.

SEC. 101. (a) Such sums as may be necessary for programs, projects, or activities provided for in the Agriculture, Rural Development and Related Agencies Appropriation Act, 1985 (H.R. 5743), to the extent and in the manner provided for in the conference report and joint explanatory statement of the Committee of Conference (House Report Numbered 98-1071), filed in the House of Representatives on September 25, 1984, as if such Act had been enacted into law.

D.C. appropriations.

(b) Such sums as may be necessary for programs, projects, or activities provided for in the District of Columbia Appropriation Act, 1985 (H.R. 5899), to the extent and in the manner provided for in the conference report and joint explanatory statement of the Committee of Conference (House Report Numbered 98-1088), filed in the House of Representatives on September 26, 1984, as if such Act had been enacted into law.

Post, p. 1838.

(c) Such amounts as may be necessary for programs, projects or activities provided for in the Department of the Interior and Related Agencies Appropriations Act, 1985, at a rate of operations and to the extent and in the manner provided as follows, to be effective as if it had been enacted into law as the regular appropriation Act:

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 69

"(1) the term 'counterfeited' means a document that purports to be genuine but is not, because it has been falsely made or manufactured in its entirety;

"(2) the term 'forged' means a document that purports to be genuine but is not because it has been falsely altered, completed, signed, or endorsed, or contains a false addition thereto or insertion therein, or is a combination of parts of two or more genuine documents;

"(3) the term 'security' means—

"(A) a note, stock certificate, treasury stock certificate, bond, treasury bond, debenture, certificate of deposit, interest coupon, bill, check, draft, warrant, debit instrument as defined in section 916(c) of the Electronic Fund Transfer Act (15 U.S.C. 1693(c)), money order, traveler's check, letter of credit, warehouse receipt, negotiable bill of lading, evidence of indebtedness, certificate of interest in or participation in any profit-sharing agreement collateral-trust certificate, pre-reorganization certificate of subscription, transferable share, investment contract, voting trust certificate, or certificate of interest in tangible or intangible property; 15 USC 1693n.

"(B) an instrument evidencing ownership of goods, wares, or merchandise;

"(C) any other written instrument commonly known as a security;

"(D) a certificate of interest in, certificate of participation in, certificate for, receipt for, or warrant or option or other right to subscribe to or purchase, any of the foregoing; or

"(E) a blank form of any of the foregoing;

"(4) the term 'organization' means a legal entity, other than a government, established or organized for any purpose, and includes a corporation, company, association, firm, partnership, joint stock company, foundation, institution, society, union, or any other association or persons which operates in or the activities of which affect interstate or foreign commerce; and

"(5) the term 'State' includes a State of the United States, the District of Columbia, Puerto Rico, Guam, the Virgin Islands, and any other territory or possession of the United States.".

(b) The analysis at the beginning of chapter 25 of title 18 is amended by adding after the item relating to section 509 the following:

"510. Securities of the State and private entities.".

Part E—Receipt of Stolen Bank Property

Sec. 1106. Subsection (c) of section 2113 of title 18 is amended to read as follows:

"(c) Whoever receives, possesses, conceals, stores, barters, sells, or disposes of, any property or money or other thing of value which has been taken or stolen from a bank, credit union, or savings and loan association in violation of subsection (b), knowing the same to be property which has been stolen shall be subject to the punishment provided in subsection (b) for the taker.".

Part F—Bank Bribery

Sec. 1107. (a) Section 215 of title 18 is amended to read as follows:

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 70

"(a) Whoever, being an officer, director, employee, agent, or attorney of any financial institution, bank holding company, or savings and loan holding company, except as provided by law, directly or indirectly, asks, demands, exacts, solicits, seeks, accepts, receives or agrees to receive anything of value, for himself or for any other person or entity, other than such financial institution, from any person or entity for or in connection with any transaction or business of such financial institution; or

"(b) Whoever, except as provided by law, directly or indirectly, gives, offers, or promises anything of value to any officer, director, employee, agent, or attorney of any financial institution, bank holding company, or savings and loan holding company, or offers or promises any such officer, director, employee, agent, or attorney to give anything of value to any person or entity, other than such financial institution, for or in connection with any transaction or business of such financial institution, shall be fined not more than $5,000 or three times the value of anything offered, asked, given, received, or agreed to be given or received, whichever is greater, or imprisoned not more than five years, or both; but if the value of anything offered, asked, given, received, or agreed to be given or received does not exceed $100, shall be fined not more than $1,000 or imprisoned not more than one year, or both.

"(c) As used in this section—

"(1) 'financial institution' means—

"(A) any bank the deposits of which are insured by the Federal Deposit Insurance Corporation;

"(B) any member, as defined in section 2 of the Federal Home Loan Bank Act, as amended, of the Federal Home Loan Bank System and any Federal Home Loan Bank;

12 USC 1422.

"(C) any institution the accounts of which are insured by the Federal Savings and Loan Insurance Corporation;

"(D) any credit union the accounts of which are insured by the Administrator of the National Credit Union Administration;

"(E) any Federal land bank, Federal land bank association, Federal intermediate credit bank, production credit association, bank for cooperatives; and

"(F) a small business investment company, as defined in section 103 of the Small Business Investment Act of 1958 (15 U.S.C. 662); and

"(2) 'bank holding company' or 'savings and loan holding company' means any person, corporation, partnership, business trust, association or similar organization which controls a financial institution in such a manner as to be a bank holding company or a savings and loan holding company under the Bank Holding Company Act Amendments of 1956 (12 U.S.C. 1841) or the Savings and Loan Holding Company Amendments of 1967 (12 U.S.C. 1730a).

12 USC 1841 note.
12 USC 1701 note.

"(d) This section shall not apply to the payment by a financial institution of the usual salary or director's fee paid to an officer, director, employee, agent, or attorney thereof, or to a reasonable fee paid by such financial institution to such officer, director, employee, agent, or attorney for services rendered to such financial institution.".

Repeal.
18 USC 216.

(b) Section 216 of title 18 is repealed, and the section analysis of chapter 11 for section 216 be amended to read:

"216. Repealed.".

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 71

PART G—BANK FRAUD

SEC. 1108. (a) Chapter 63 of title 18 of the United States Code is amended by adding a new section as follows:

"§ 1344. Bank fraud 18 USC 1344.

"(a) Whoever knowingly executes, or attempts to execute, a scheme or artifice—

"(1) to defraud a federally chartered or insured financial institution; or

"(2) to obtain any of the moneys, funds, credits, assets, securities or other property owned by or under the custody or control of a federally chartered or insured financial institution by means of false or fraudulent pretenses, representations, or promises, shall be fined not more than $10,000, or imprisoned not more than five years, or both.

"(b) As used in this section, the term 'federally chartered or insured financial institution' means—

"(1) a bank with deposits insured by the Federal Deposit Insurance Corporation;

"(2) an institution with accounts insured by the Federal Savings and Loan Insurance Corporation;

"(3) a credit union with accounts insured by the National Credit Union Administration Board;

"(4) a Federal home loan bank or a member, as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422), of the Federal home loan bank system; or

"(5) a bank, banking association, land bank, intermediate credit bank, bank for cooperatives, production credit association, land bank association, mortgage association, trust company, savings bank, or other banking or financial institution organized or operating under the laws of the United States.".

(b) The analysis for chapter 63 of title 18 of the United States Code is amended by adding at the end thereof the following:

"1344. Bank fraud.".

PART H—POSSESSION OF CONTRABAND IN PRISON

SEC. 1109. (a) Section 1791 of title 18, United States Code is amended to read as follows:

"§ 1791. Providing or possessing contraband in prison

"(a) OFFENSE.—A person commits an offense if, in violation of a statute, or a regulation, rule, or order issued pursuant thereto—

"(1) he provides, or attempts to provide, to an inmate of a Federal penal or correctional facility—

"(A) a firearm or destructive device;

"(B) any other weapon or object that may be used as a weapon or as a means of facilitating escape;

"(C) a narcotic drug as defined in section 102 of the Controlled Substances Act (21 U.S.C. 802);

"(D) a controlled substance, other than a narcotic drug, as defined in section 102 of the Controlled Substances Act (21 U.S.C. 802), or an alcoholic beverage;

"(E) United States currency; or

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 72

18 USC §657 research.

24

8th Cir jury instr - embezzlement (18 USC §659 ?)

COURT'S INSTRUCTION NO. _____

The crime of embezzlement of bank funds, as charged in Count ^C of the indictment, has five essential elements, which are:

One, the defendant was ^C;

Two, the defendant embezzled the funds of the bank;

Three, the amount so embezzled was more than $100.00;

Four, the defendant did so with the intent to defraud the bank; and

Five, the bank was insured by the FDIC.

"Embezzlement" means the voluntary and intentional taking, or conversion to one's own use, of the property of another, which property came into the defendant's possession lawfully, by virtue of some office, employment, or position of trust which the defendant held. "Misapplication" means the unauthorized, or unjustifiable or wrongful use of a bank's funds. Misapplication includes the wrongful taking or use of money of the bank by a bank officer or employee for his own benefit or for the use and benefit of some other person.

To act with "intent to injure" means to act with intent to cause pecuniary loss. To act with "intent to defraud" means to act with intent to deceive or cheat, for the purpose of causing a financial loss to someone else or bringing about a financial gain to defendant or another.

^C

8CCA NO. 6.18.659A

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 74

mscppl. of
bank funds
(cases)

person "connected to" inst. shd be construed broadly.

UNITED STATES of America, Plaintiff-Appellee,
v.
Don C. DAVIS, Defendant-Appellant.
UNITED STATES of America, Plaintiff-Appellee,
v.
Daniel M. BURKE, Defendant-Appellant.

Nos. 89-8051, 89-8052, 90-8057, 90-8058.

United States Court of Appeals,
Tenth Circuit.

Jan. 22, 1992.

Defendants were convicted in the United States District Court for the District of Wyoming, Alan B. Johnson, J., of various bank fraud offenses, and they appealed. The Court of Appeals, Baldock, Circuit Judge, held that: (1) one defendant's death pending appeal required dismissal of his appeal and remand to District Court with instructions to dismiss underlying indictment; (2) agency relationship existed between defendant and bank, as required to support conviction for misapplying federally insured funds and making false entries in bank books and records; (3) superseding indictment did not impermissibly amend charges in original indictment; (4) defendant could be convicted of misapplication of bank funds based on his alleged failure to disclose self-dealing in connection with bank's investment in various securities; (5) defendant could be convicted for misapplying bank funds used to purchase subordinated debentures in bank holding companies; and (6) federal agencies acted within their supervisory capacities in securing and exchanging information concerning defendant's activities.

Affirmed in part, dismissed in part, and remanded.

[1] CRIMINAL LAW ⚿ 1070
110k1070
Defendant's death pending appeal required dismissal of appeal and remand to district court with instructions to vacate judgment and dismiss underlying indictment.

[1] CRIMINAL LAW ⚿ 1192
110k1192
Defendant's death pending appeal required dismissal of appeal and remand to district court with instructions to vacate judgment and dismiss underlying indictment.

[2] CRIMINAL LAW ⚿ 1104(3)
110k1104(3)
Pages of transcript should be numbered in single series of consecutive page numbers for each proceeding, regardless of number of days involved.

[3] BANKS AND BANKING ⚿ 509.10
52k509.10
Agency relationship existed between defendant and bank, as required to support conviction for misapplying federally insured funds and making false entries in bank books and records or unlawful receipt of benefits; defendant often

attended board meetings, providing financial advice to bank's board and its president, and, with codefendant, was able to acquire control of majority of bank's shares. 18 U.S.C.A. §§ 657, 1006.

[3] BANKS AND BANKING ⚿ 509.15
52k509.15
Agency relationship existed between defendant and bank, as required to support conviction for misapplying federally insured funds and making false entries in bank books and records or unlawful receipt of benefits; defendant often attended board meetings, providing financial advice to bank's board and its president, and, with codefendant, was able to acquire control of majority of bank's shares. 18 U.S.C.A. §§ 657, 1006.

[4] BANKS AND BANKING ⚿ 509.10
52k509.10
Bank customer may be convicted as aider and abetter under criminal statutes prohibiting misapplication of federally insured funds and making false entries in bank books and records or unlawful receipt of benefits when principal, an officer, agent, employee or other person connected in any capacity of trust with the institution, is found guilty of the offense. 18 U.S.C.A. §§ 657, 1006.

[4] BANKS AND BANKING ⚿ 509.15
52k509.15
Bank customer may be convicted as aider and abetter under criminal statutes prohibiting misapplication of federally insured funds and making false entries in bank books and records or unlawful receipt of benefits when principal, an officer, agent, employee or other person connected in any capacity of trust

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with the institution, is found guilty of the offense. 18 U.S.C.A. §§ 657, 1006.

[5] BANKS AND BANKING ⚿ 509.10
52k509.10
Those who serve federally insured institution, whether in employment context or in some other position of trust, are "connected with" that institution under statute prohibiting misapplication of federally insured funds or making false entries in bank books and records or unlawful receipt of benefits. 18 U.S.C.A. §§ 657, 1006.

[5] BANKS AND BANKING ⚿ 509.15
52k509.15
Those who serve federally insured institution, whether in employment context or in some other position of trust, are "connected with" that institution under statute prohibiting misapplication of federally insured funds or making false entries in bank books and records or unlawful receipt of benefits. 18 U.S.C.A. §§ 657, 1006.

[6] BANKS AND BANKING ⚿ 509.10
52k509.10
For purposes of statute prohibiting misapplication of federally insured funds and making false entries in bank books and records or unlawful receipt of benefits, connection with federally protected institution may result from control through stock ownership, or control through power to extend credit; such direct control, however, is not essential to finding that defendant is connected with institution. 18 U.S.C.A. §§ 657, 1006.

[6] BANKS AND BANKING ⚿ 509.15
52k509.15
For purposes of statute prohibiting misapplication of federally insured funds and making false entries in bank books and records or unlawful receipt of benefits, connection with federally protected institution may result from control through stock ownership, or control through power to extend credit; such direct control, however, is not essential to finding that defendant is connected with institution. 18 U.S.C.A. §§ 657, 1006.

[7] BANKS AND BANKING ⚿ 509.15
52k509.15
Statute prohibiting misapplication of federally insured funds does not require Government to prove that defendant performed ministerial task of disbursement. 18 U.S.C.A. § 657.

[8] CRIMINAL LAW ⚿ 159
110k159
Superseding indictment did not impermissibly amend charges in an original indictment charging defendant with wire fraud, so as to cause superseding indictment to be barred by limitations; while defendant claimed that superseding indictment changed entire theory of criminal liability from scheme to transfer $20 million for benefit of defendants to scheme to obtain control of three financial institutions, conspiracy count in original indictment covered not only defendant's control activities, but also transactions involving acquisition of controlling interest. 18 U.S.C.A. §§ 1001, 1005, 1006, 1014, 3282.

[9] CRIMINAL LAW ⚿ 157
110k157
Date of original indictment tolls limitations period as to charges alleged.

[10] CRIMINAL LAW ⚿ 159
110k159
Superseding indictment filed while first indictment is validly pending is not barred by statute of limitations unless it broadens or substantially amends charges in first indictment.

[11] INDICTMENT AND INFORMATION ⚿ 15(1)
210k15(1)
If allegations and charges contained in superseding indictment are substantially the same as those contained in original indictment, sufficient notice is presumed.

[12] INDICTMENT AND INFORMATION ⚿ 15(1)
210k15(1)
Indictment is not amended impermissibly by superseding indictment which names greater or lesser number of defendants as coconspirators or contains slightly different mix of closely related statutory violations as objects of conspiracy, provided essential nature of conspiracy alleged in first indictment remains the same.

[13] CRIMINAL LAW ⚿ 835
110k835
Defendant's "theory of the defense" instructions

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were properly rejected by trial court in bank fraud prosecution, where instructions were essentially summaries of the evidence in light most favorable to defense, marshaled facts supporting defendant's version of events, and would have precluded jury from finding elements of various charged offenses.

[14] CRIMINAL LAW ⚭ 772(6)
110k772(6)
Defendant is entitled to correct instructions on defenses supported by sufficient evidence for jury to find in defendant's favor.

[14] CRIMINAL LAW ⚭ 814(8)
110k814(8)
Defendant is entitled to correct instructions on defenses supported by sufficient evidence for jury to find in defendant's favor.

[15] CRIMINAL LAW ⚭ 769
110k769
District judge has substantial discretion in formulating jury instruction; Court of Appeals' review is confined to determining whether instructions as a whole sufficiently cover issues presented by evidence and constitute correct statements of the law.

[15] CRIMINAL LAW ⚭ 822(1)
110k822(1)
District judge has substantial discretion in formulating jury instruction; Court of Appeals' review is confined to determining whether instructions as a whole sufficiently cover issues presented by evidence and constitute correct statements of the law.

[16] CRIMINAL LAW ⚭ 822(1)
110k822(1)
Jury instructions are considered as a whole; particular jury instruction is not to be read in isolation.

[17] BANKS AND BANKING ⚭ 509.15
52k509.15
Defendant, as agent of bank, could be convicted of misapplication of bank funds based on his alleged failure to disclose self-dealing in connection with bank's investment in various securities, even if money invested by bank was used by recipient corporations in way promised to bank. 18 U.S.C.A. § 657.

[18] BANKS AND BANKING ⚭ 509.15
52k509.15
Misapplication of bank funds may occur when officer, director, employee or other person subject to misapplication statute knowingly lends money to sham borrower or causes all or part of loan to be made for his or her own benefit while concealing his or her interest from bank. 18 U.S.C.A. § 657.

[19] BANKS AND BANKING ⚭ 509.15
52k509.15
When person within ambit of statute prohibiting misapplication of bank funds receives material benefits of loans without disclosing this fact, misapplication has occurred. 18 U.S.C.A. § 657.

[20] BANKS AND BANKING ⚭ 509.15
52k509.15
Trier of fact is not restricted solely to immediate transferee of bank funds when determining whether misapplication has occurred. 18 U.S.C.A. § 657.

[21] BANKS AND BANKING ⚭ 509.15
52k509.15
Defendant, as agent of bank, could be convicted of misapplying bank funds used to purchase subordinated debentures in bank holding companies, where holding companies spent portion of funds to acquire option in corporation which allegedly paid substantial sums to defendant. 18 U.S.C.A. §§ 656, 657.

[22] BANKS AND BANKING ⚭ 509.15
52k509.15
Bank's decision to purchase securities in amounts which exceeded legitimate use of those funds constituted misapplication of bank funds. 18 U.S.C.A. § 657.

[23] BANKS AND BANKING ⚭ 509.15
52k509.15
In determining whether statute prohibiting misapplication of bank funds has been violated, Court of Appeals looks at substance of transactions, even if multiple entities are involved. 18 U.S.C.A. § 657.

[24] BANKS AND BANKING ⚭ 509.20
52k509.20
Defendant could be convicted of overvaluing security by submitting false appraisal report to bank in connection with loan, although bank did not

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receive report until after one year after loan was made and note matured; bank sought appraisal as condition of initiation and continuation of loan, and Government was not required to prove that bank actually relied upon the appraisal. 18 U.S.C.A. § 1014.

[25] BANKS AND BANKING ⚿ 509.10
52k509.10
Defendant could be convicted of making false entry in bank records based on his meeting with member of board of directors which allegedly caused member to make false entries in bank minutes at subsequent directors' meeting; it was sufficient that defendant knowingly "set into motion" or knowingly participated in events which would necessarily cause false entries to be made. 18 U.S.C.A. §§ 1005, 1006.

[26] BANKS AND BANKING ⚿ 235
52k235
Federal Reserve Board (FRB), Federal Home Loan Bank Board (FHLBB) and Office of Controller of Currency (OCC) acted within their supervisory capacities in securing and exchanging information concerning defendant's activities with respect to bank holding companies and individual banks, so that Right to Financial Privacy Act did not apply to information disclosed by those agencies concerning defendant's bank transactions in connection with criminal investigation. Financial Institutions Regulatory and Interest Rate Control Act of 1978, §§ 1101-1122, 12 U.S.C.A. §§ 3401-3422.

[26] BANKS AND BANKING ⚿ 353
52k353
Federal Reserve Board (FRB), Federal Home Loan Bank Board (FHLBB) and Office of Controller of Currency (OCC) acted within their supervisory capacities in securing and exchanging information concerning defendant's activities with respect to bank holding companies and individual banks, so that Right to Financial Privacy Act did not apply to information disclosed by those agencies concerning defendant's bank transactions in connection with criminal investigation. Financial Institutions Regulatory and Interest Rate Control Act of 1978, §§ 1101-1122, 12 U.S.C.A. §§ 3401-3422.

[26] BANKS AND BANKING ⚿ 451
52k451
Federal Reserve Board (FRB), Federal Home Loan Bank Board (FHLBB) and Office of Controller of Currency (OCC) acted within their supervisory capacities in securing and exchanging information concerning defendant's activities with respect to bank holding companies and individual banks, so that Right to Financial Privacy Act did not apply to information disclosed by those agencies concerning defendant's bank transactions in connection with criminal investigation. Financial Institutions Regulatory and Interest Rate Control Act of 1978, §§ 1101-1122, 12 U.S.C.A. §§ 3401-3422.

[27] CRIMINAL LAW ⚿ 394.1(2)
110k394.1(2)
Even had Right to Financial Privacy Act been violated in connection with disclosure of various government agencies concerning defendant's bank transactions, suppression was not available remedy, nor was dismissal of indictment. Financial Institutions Regulatory and Interest Rate Control Act of 1978, § 1117(d), 12 U.S.C.A. § 3417(d).

[27] INDICTMENT AND INFORMATION ⚿ 144.1(1)
210k144.1(1)
Even had Right to Financial Privacy Act been violated in connection with disclosure of various government agencies concerning defendant's bank transactions, suppression was not available remedy, nor was dismissal of indictment. Financial Institutions Regulatory and Interest Rate Control Act of 1978, § 1117(d), 12 U.S.C.A. § 3417(d).

[28] CRIMINAL LAW ⚿ 412.2(2)
110k412.2(2)
Defendant's meeting with Federal Reserve Board (FRB) agents to discuss financial problems of two bank holding companies was not custodial interrogation for Miranda purposes, although FRB had sent criminal referral to United States attorney two days earlier identifying several insiders of holding companies as targets. U.S.C.A. Const.Amend. 5.

[29] BANKS AND BANKING ⚿ 235
52k235
Government agency charged with bank oversight may develop information in civil matters which may be relevant in potential criminal prosecution.

[30] CRIMINAL LAW ⚿ 986.4(1)
110k986.4(1)

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Rule giving attorney for Government equivalent opportunity to speak to court at sentencing did not preclude Government's filing of written sentencing memorandum. Fed.Rules Cr.Proc.Rule 32(a)(1), 18 U.S.C.A.

[31] CRIMINAL LAW ⇐ 986.4(1)
110k986.4(1)
Only if Government's sentencing memorandum is incorporated expressly into presentence report and defendant objects to material contained in memorandum is compliance with rule governing objections to presentence report necessary. Fed.Rules Cr.Proc.Rule 32(c)(3)(D), 18 U.S.C.A.

[32] MANDAMUS ⇐ 61
250k61
Defense counsel was not entitled to writ of mandamus requiring district court to process his interim vouchers for payment of fees and expenses pursuant to Criminal Justice Act, where counsel had not complied with rule requiring filing of separate petition and proof of service on respondent judge, as well as other parties. 18 U.S.C.A. §§ 3006A, 3006A(d)(4); F.R.A.P.Rule 21(a), 28 U.S.C.A.; 28 U.S.C.A. §§ 1291, 1651(a).

[33] CRIMINAL LAW ⇐ 1023(1)
110k1023(1)
Fee determinations by district judge pursuant to Criminal Justice Act are administrative in character and do not constitute final appealable orders within meaning of statute governing jurisdiction of Court of Appeals. 18 U.S.C.A. § 3006A; 28 U.S.C.A. § 1291.

[34] MANDAMUS ⇐ 61
250k61
Court of Appeals could consider defense counsel's request for writ of mandamus requiring district court to process his interim vouchers for payment of fees

and expenses pursuant to Criminal Justice Act. 18 U.S.C.A. § 3006A; 28 U.S.C.A. § 1651(a).

***1485** Todd L. Vriesman (John A. Sbarbaro with him on the brief) of Kirkland & Ellis, Denver, Colo., for defendant-appellant Don C. Davis.

E. James Burke and Rhonda S. Woodard, of Burke, Woodard & Bishop, P.C., Cheyenne, Wyo., for defendant-appellant Daniel M. Burke.

Francis Leland Pico, Asst. U.S. Atty. (Richard A. Stacy, U.S. Atty., & David A. Kubichek with him on the brief), Cheyenne, Wyo., for plaintiff-appellee.

***1486** Before ANDERSON, BALDOCK and EBEL, Circuit Judges.

BALDOCK, Circuit Judge.

This case involves the theft of federally insured deposits through a series of complicated financial transactions involving collusion, deception, self-dealing and conflict of interest. Defendants Don C. Davis and Daniel M. Burke diverted or misapplied millions of dollars at the expense of several banks and savings and loan institutions, and ultimately the United States treasury. [FN1] The fraud required false representations to, and the concealing of important information from, bank examiners, bank directors and bank officers.

> FN1. Defendant John Edmiston was charged in a single count, pled guilty and testified against Davis and Burke. Edmiston was the president of First National Bank of Evanston (FNBE), owned an interest in the bank through the holding company, and served on the bank's board of directors.

By superseding indictment, both defendants were charged with one count of conspiracy to commit offenses against and to defraud the United States (count 1), 18 U.S.C. § 371; nine counts of wire fraud (counts 2-10), 18 U.S.C. § 1343; five counts of misapplying federally insured funds (counts 11-14, 16), 18 U.S.C. § 657; three counts of making false entries in bank books and records or unlawful receipt of benefits (counts 15, 20 & 21), 18 U.S.C. § 1006. Davis also was charged in two counts of overvaluing security and making false statements (counts 18 & 19), 18 U.S.C. § 1014. After a ten-week trial in which the trial judge displayed consummate patience, the jury convicted Davis on fourteen counts including the conspiracy count (count 1), five counts of wire fraud (counts 3-6, 9), four counts of misapplying federally insured funds (counts 11-13, 16), two counts of aiding and abetting false entries (counts 15 & 21), one count of aiding and abetting in the unlawful receipt of benefits (count 20), and one count of overvaluing security (count 18). The jury convicted Burke on eleven counts, including the conspiracy count (count

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1), three counts of wire fraud (counts 4-6), four counts of misapplying federally insured funds (counts 11, 12, 14 & 16) two counts of making false entries (count 15 & 21) and one count of unlawfully receiving benefits (count 20). The district court, for these pre-Sentencing Guidelines offenses, sentenced Davis to six years imprisonment and Burke to four years. These appeals followed.

[1] After submission of these appeals, we affirmed the imposition of civil monetary penalties against defendants based on violations of cease and desist orders of the Federal Reserve Board. Burke v. Board of Governors, 940 F.2d 1360 (10th Cir.1991). Burke died on December 6, 1991. Thereafter, the government filed a suggestion of death. Burke's counsel, on behalf of the family, opposed dismissal, seeking an appellate decision on the merits. We respect the wishes of the family, but the law provides a more advantageous resolution: "death pending direct review of a criminal conviction abates not only the appeal but also all proceedings had in the prosecution from its inception." See Durham v. United States, 401 U.S. 481, 483, 91 S.Ct. 858, 860, 28 L.Ed.2d 200 (1971) (per curiam) (footnote omitted), overruled on other grounds, Dove v. United States, 423 U.S. 325, 96 S.Ct. 579, 46 L.Ed.2d 531 (1976) (per curiam) (eliminating Durham rule for petitions for certiorari, but not for appeals of right). See also United States v. Williams, 874 F.2d 968, 970 (5th Cir.1989); United States v. Schumann, 861 F.2d 1234, 1236 (11th Cir.1988); United States v. Mollica, 849 F.2d 723, 725-26 (2d Cir.1988); United States v. Littlefield, 594 F.2d 682, 683 (8th Cir.1979); United States v. Bechtel, 547 F.2d 1379, 1380 (9th Cir.1977). Accordingly, as to Burke, we shall dismiss his appeal and remand the criminal judgment against him to the district court with instructions to vacate the judgment and dismiss the underlying indictment. See Id.

I.

The government's case involved five transactions. We briefly outline these ***1487** transactions before reaching the merits of Davis's appeal.

A. Acquisition of FNBE

The first transaction involved the acquisition of the First National Bank of Evanston, Wyoming (FNBE) by EVCO, Inc., a bank holding company, by a group of investors. Defendants Burke, Davis and Edmiston, see supra n. 1, first sought to acquire FNBE in 1982. All were well connected with other federally insured financial institutions. Davis was a major stockholder, board chairman and president of the Stockgrower's State Bank Company (SSBC), the bank holding company which owned Stockgrower's State Bank (SSB). Likewise, Edmiston was a stockholder and board member of SSBC. Burke was a board member of Guaranty Federal Bank (GFB).

Ultimately, the Federal Reserve Bank approved a $10 million acquisition of FNBE by a different investor group (the Burke group) with no more than a 3:1 debt-to-equity ratio ($7.5 million of debt) and no involvement of Davis and coinvestor Robert L. Anderson. Based on a series of false representations by Davis and Burke, however, the acquisition was financed for $12.5 million by Omaha National Bank, SSB, GFB and Provident Federal Bank. With the assistance of Burke, Davis directed the wire transfer of over $2 million for uses unrelated to the acquisition of FNBE. A total of $3.1 million of the acquisition funding was diverted to Davis and Anderson.

B. GFB Purchase of Bank Holding Company Securities

GFB, and its wholly owned subsidiary Powder River Service Corp. (PRSC), purchased $1.5 million in subordinated debentures and $1 million in preferred stock issued by EVCO and another bank holding company, SSBC. Burke and Davis exercised control of GFB as part of a group which had majority stock ownership. While Burke served as a director, Davis frequently gave financial advice to the board and attended several GFB board meetings. Burke and Davis were instrumental in persuading GFB's president, Tom Hogan, to purchase these securities. See X Tr. 60. The proceeds were to enable EVCO and SSBC to activate Wyoming Financial Services (WFS), a recently formed corporation. In reality, WFS served as a conduit to funnel approximately $701,000 to Davis and $54,000 to Burke. See XII Tr. 100-11.

C. Elkhorn Land Deal

[2] In May 1984, a limited partnership, in which PRSC had an 84% interest, purchased land owned

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by the Elkhorn Land and Livestock Company. Burke and Davis persuaded the GFB Board to fund PRSC's participation in the amount of $1.65 million, with the understanding that the proceeds would be used to pay existing indebtedness on the land. Only $1.15 million was used for that purpose; Davis received the remaining $500,000 as a secret commission. Several months later, Burke and Davis had GFB's attorney prepare a "clarifying" minute entry indicating that the commission had been authorized by the GFB board when, in fact, it had not. See Pl. ex. 914; VIII R.S. 19. Although Burke abstained from the vote on the amendment, he and Davis took steps leading to its preparation. GFB executive vice-president Mike Brown approved the amendment only because he did not want to be fired. XXXII Tr. 31. [FN2]

FN2. Our resolution of these appeals has been delayed substantially because the transcript consists of over one-hundred volumes in an order which does not allow for ready reference or chronological review. For example, the testimony of various witnesses is contained out of order in supplemental volumes. We note that the pages of a transcript should be numbered in a single series of consecutive page numbers for each proceeding, regardless of the number of days involved. Given the magnitude of this trial, all pages should have been numbered consecutively for the entire multiple-volume transcript and we so direct for the future. See VI Administrative Office of the U.S. Courts, Guide to Judiciary Policies and Procedures-Court Reporters' Manual ch. XVIII, pt. k(2) (example set 2) (Oct. 91).

D. Dakota Minerals Deal

Burke and Davis agreed to purchase stock in Dakota Minerals, Inc. (Dakota) and initially secure a $1.75 million loan for Dakota. ***1488** Dakota would pay a future fee of $4 million and grant stock options to Burke and Davis for their assistance in securing additional financing. At a GFB board meeting in June 1984, Burke and Davis advocated a $1.75 million loan to Dakota and Burke voted in favor of it, all without mention of their personal interest in the loan. The agreement between Davis, Burke and Dakota, though partially performed, was never executed. Davis and Burke expressed apprehension about signing the agreement when bank examiners were examining GFB.

E. GFB Loan to Tired Iron, Inc.

The final transaction concerned GFB's $650,000 loan to Tired Iron, a company owned by Davis. Davis agreed to provide an itemized list of collateral (aircraft parts, supplies and tools) with a value of $893,000 to secure the note. Pl. ex. 739, 747 & 751. Almost a year later, Davis provided the list which appraised the collateral at $1.45 million. Pl. ex. 752. The appraisal was done by Jay Johnson at the request and direction of Davis. Johnson had seen the parts one or two years previously, but did not inspect the inventory at the time he provided his estimate of a retail value of $1.45 million. The evidence tended to show that the parts were worth a maximum of $425,000 at retail and $170,000 at wholesale; a more realistic figure was $50,000 to $60,000, given a quick sale. Pl. ex. 754; XXXIII Tr. 42-110.

II.

[3] Defendant Davis first argues that his convictions under 18 U.S.C. § 657 and § 1006 are invalid because the trial evidence did not establish an essential element of those offenses, namely that Davis was an officer, agent or employee of a federally insured institution. "[T]he relevant question is whether, after viewing the evidence in the light most favorable to the prosecution, any rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt." Jackson v. Virginia, 443 U.S. 307, 319, 99 S.Ct. 2781, 2789, 61 L.Ed.2d 560 (1979).

Under § 657, it is unlawful for a person who is "an officer, agent or employee of or connected in any capacity with" an insured institution to willfully misapply funds belonging to the institution. Likewise, under § 1006, it is unlawful for "an officer, agent or employee of or connected in any capacity with" an insured institution to make any false entry into its books, or, with intent to defraud the institution, to participate in or receive any money or other benefits through any transaction or act of the institution. [FN3]

FN3. We note that the parallel statute, 18 U.S.C. § 1005 (pertaining to national banks), does not contain the class limitation contained in §§ 656, 657 and 1006. See United States v. Edick, 432 F.2d 350, 352 (4th Cir.1970).

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Davis was not an officer or employee of GFB, and he argues that no evidence indicates that he acted as an agent of GFB. He points to cross-examination of Tom Hogan, president of GFB, and Art Volk, board chairman of GFB, wherein these witnesses responded that Davis was not an agent of GFB. Merely because Davis had not been designated as an agent of GFB does not preclude a trier of fact from determining that an agency relationship existed based upon conduct. As important, the government was required to prove only that Davis was a person "connected in any capacity with" an insured financial institution for purposes of §§ 657 and 1006. [FN4]

FN4. Davis cites the district court's order granting bail pending appeal for the proposition that the district court "conceded that the factual predicate for liability under the statutes was lacking" when it indicated that Davis was neither an employee or officer or an agent of GFB. See Davis's Brief at 26 (citing VI R. doc. 431 at 18). Not so. The district court determined that Davis acquired GFB stock for himself and for nominees and served as a financial consultant to GFB. From these operative facts and its prescient view of the broad construction we would afford §§ 657 and 1006, the district court reasoned that Davis was indeed "connected in any capacity with" an insured financial institution.

[4] During the period alleged in the superseding indictment, Burke was a director of GFB and Davis often attended board meetings, providing financial advice to the ***1489** GFB board and its president. See XXXII Tr. 37; III S.R. 11; VIII S.R. 119, 122. Burke and Davis were able to acquire control of a majority of GFB shares and, hence, controlled the GFB board. [FN5] See, e.g., XXIII Tr. 17. Although Davis argues that he was not a financial consultant to GFB, the testimony of Tom Hogan, the former president of GFB, certainly indicates otherwise. See, e.g., VII R.S. 34; VIII R.S. 21, 62-64, 83-84, 119; IX R.S. 10, 66. A consulting contract or agreement was not required. One cannot read this transcript in its entirety and fail to develop a definite and firm conviction that Burke and Davis were tireless in their self-dealing when it came to influencing bank transactions. [FN6]

FN5. Davis contends that he owned only 1.6% (4,600) of GFB shares. See Davis's Brief at 18 n. 15 & Reply Brief at 7. This conveniently ignores the GFB shares he purchased through nominees. Moreover, we look to Davis's effective control over the board given his alliance with Burke and other shareholders. When GFB was converted from a mutual company to a stock owned bank, Burke and Davis caused the number of directors on the GFB board to be reduced from twelve to five (one of whom was Burke), and made clear to remaining directors that it was their way or the highway.

FN6. Davis's implication that he was a mere customer of GFB (and therefore not liable under §§ 657 and 1007) is flatly contradicted by the record. Moreover, we note that a bank customer may be convicted as an aider and abetter under these statutes when the principal (an officer, agent, employee or other person connected in any capacity of trust with the institution) is found guilty of the offense. See United States v. Giordano, 489 F.2d 327, 330 (2d Cir.1973); United States v. Tornabene, 222 F.2d 875, 878 (3d Cir.1955). We note that the jury did indeed convict Davis of aiding and abetting Burke on some of the counts.

Davis contends, however, that only "officers, agents, or employees" who are "connected in any capacity with" an insured financial institution may be found liable under §§ 657 and 1006. According to Davis, "[t]he statutes apply only to officers, agents or employees, but allow those persons to be officers, agents or employees of [the institution] or, alternatively, officers, agents or employees connected in any capacity to [the institution]." Davis's Brief at 20. Davis further contends that § 657 requires the government to prove that a defendant had direct access to bank funds as an insider and used his position to victimize the bank.

Davis's construction of these statutes is too narrow. It would require us to strike out the following italicized words: "Whoever, being an officer, agent or employee of or connected in any capacity with...." 18 U.S.C. §§ 657, 1006. While the class of persons coming within the statutes is limited by a relationship of trust, and in the case of § 657, direct or indirect access to bank assets, these statutes are not limited solely to bank officers, agents or employees. Moreover, if the trier of fact determines that a principal within the class has committed bank fraud, a person outside the class such as a bank customer may be held liable as an aider and abetter. United States v. Cooper, 464

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F.2d 648, 649-50 (10th Cir.1972), cert. denied, 409 U.S. 1107, 93 S.Ct. 902, 34 L.Ed.2d 688 (1973); United States v. Tornabene, 222 F.2d 875, 877-78 (3rd Cir.1955).

We recently decided that the person "connected in any capacity with" language of § 657 should be given a "broad interpretation" in accordance with congressional intent of protection of federally insured institutions against fraud. In United States v. Ratchford, 942 F.2d 702 (10th Cir.1991), we held that a property manager who diverted funds from an apartment complex owned by two savings and loan associations was sufficiently connected to federally insured institutions to support conviction under § 657. Id. at 705.

> As president and owner of the managing company, defendant was aware of the savings and loans' ownership of the complex and that his ultimate responsibility was to these owners. It was in this position of trust that he diverted funds he knew belonged to these institutions to his own personal use.

Id. at 704. Although "each case is fact specific," id. at 705, several cases support the government's position that either (1) a stockholder who exerts control or (2) a financial adviser of a federally protected institution ***1490** may be within reach of these statutes. Both persons occupy "position[s] of trust." See Id. at 704.

[5][6] In United States v. Prater, 805 F.2d 1441 (11th Cir.1986) (cited in Ratchford) the president of a real estate subsidiary wholly owned by an S & L was "connected with" the S & L under §§ 657 and 1006. Id. at 1446. The president of the real estate subsidiary had the power to initiate loans and the S & L board relied upon him for accurate recommendations concerning loans. Id. Those who serve a federally insured institution, whether in an employment context or in some other position of trust, are "connected with" that institution under §§ 657 and 1006. See id.; United States v. Rice, 645 F.2d 691, 693 (9th Cir.) (consultant retained by S & L to originate loans was "connected with" S & L under § 1006, notwithstanding he had no right to approve loans), cert. denied, 454 U.S. 862, 102 S.Ct. 318, 70 L.Ed.2d 160 (1981); United States v. Edick, 432 F.2d 350, 352 (4th Cir.1970) (employee of bank service corporation was connected with bank under § 656; "[i]t was because of his intimate relation to the bank's business and its records, in a position of trust, that he was able to divert its funds and make false entries in its records"). A connection with a federally protected institution may result from control through stock ownership, or control through the power to extend credit. Such direct control, however, is not essential to a finding that a defendant is connected with the institution. United States v. Payne, 750 F.2d 844, 855 (11th Cir.1985).

Garrett v. United States, 396 F.2d 489 (5th Cir.), cert. denied, 393 U.S. 952, 89 S.Ct. 374, 21 L.Ed.2d 364 (1968), presented circumstances analogous to the present case. In Garrett, controlling stockholders of a bank were charged with misapplication of national bank funds in connection with the purchase of mortgages by the bank. See 18 U.S.C. § 656 (proscribing willful misapplication of national bank funds by "[w]ho[m]ever, being an officer, director, agent or employee of, or connected in any capacity with ... [the financial institution]"). The bank paid face value for the mortgages; the seller then paid a large commission to a nonbank corporation owned by the defendants. The funds were deposited into a corporate bank account and immediately disbursed to the defendants by a series of checks. Defendants argued that because they were not officers, directors, agents or employees of the bank, they were not within the reach of the statute. The Fifth Circuit disagreed after examining the connection between the defendants and the bank. Defendants and their nominees obtained control of a majority of shares of the bank and arranged for the election of employees and associates to constitute a majority on the bank board. As controlling stockholders, defendants had a fiduciary duty not only to minority stockholders, but also to the bank. Id. at 491. Defendants participated in arranging the transactions resulting in their indictment. The court concluded that the "fact of ownership ... together with the activity ... in furtherance of control demonstrates a connection with the bank within the meaning of the statute." Id. at 491. The purpose of the statute is to protect and preserve bank assets. Id.

[7] On this point, no significant difference exists between the statutes in this case and the bank statute in Garrett. As noted, Burke and Davis exercised control of GFB and were active in the affairs of GFB. Davis's assertion to the contrary is not in accord with the evidence when viewed in the light

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most favorable to the government. See Davis's Reply Brief at 5. Davis further contends that he lacked direct access to funds, but § 657 does not require the government to prove that Davis performed the ministerial task of disbursement.

III.

[8] Davis next argues that wire fraud counts 2-10, occurring in March and April, 1983, were time-barred because the superseding indictment was not returned until August 18, 1988, outside the five year limitation period. See 18 U.S.C. § 3282. Although the original indictment in this case was returned within the limitation period ***1491** (November 13, 1987), Davis contends that the superseding indictment impermissibly broadened or substantially amended these charges.

[9][10][11] The date of the original indictment tolls the limitations period as to charges alleged. See United States v. Jones, 816 F.2d 1483, 1487 (10th Cir.1987). A superseding indictment filed while the first indictment is validly pending is not barred by the statute of limitations unless it broadens or substantially amends the charges in the first indictment. United States v. Schmick, 904 F.2d 936, 940 (5th Cir.1990), cert. denied, ---U.S. ----, 111 S.Ct. 782, 112 L.Ed.2d 845 (1991); United States v. Grady, 544 F.2d 598, 602 (2d Cir.1976). "[N]otice is the touchstone in deciding whether a superseding indictment substantially changes the original charges." United States v. Gengo, 808 F.2d 1, 3 (2d Cir.1986). If the allegations and charges contained in the superseding indictment are "substantially the same" as those contained in the original indictment, sufficient notice is presumed. See Schmick, 904 F.2d at 940.

[12] The two indictments allege identical wire transfers as part of a scheme to defraud. Davis claims that the superseding indictment changed the entire theory of criminal liability from a scheme to transfer $20 million for the benefit of the defendants to a scheme to obtain control of three financial institutions, FNBE, SSB and GFB. See Davis's Brief at 23; Reply Brief at 10-12. The wire fraud counts incorporate the conspiracy count which was modified in the superseding indictment. Davis notes that the conspiracy count of the superseding indictment did not include a previously named defendant and omitted various objects of the conspiracy (offenses under 18 U.S.C. §§ 1001 and 1005). Davis's Brief at 23. Davis also points out that additional objects of the conspiracy were added, namely the commission of offenses under 18 U.S.C. §§ 1006 and 1014. An indictment is not amended impermissibly by a superseding indictment which names a greater or lesser number of defendants as coconspirators or contains a slightly different mix of closely related statutory violations as objects of the conspiracy, provided the essential nature of the conspiracy alleged in the first indictment remains the same. See United States v. Sears, Roebuck & Co., 785 F.2d 777, 779 (9th Cir.), cert. denied, 479 U.S. 988, 107 S.Ct. 580, 93 L.Ed.2d 583 (1986); United States v. Panebianco, 543 F.2d 447, 454 (2d Cir.1976), cert. denied, 429 U.S. 1103, 97 S.Ct. 1129, 51 L.Ed.2d 553 (1977).

For purposes of the scheme or artifice to defraud incorporated into the wire fraud counts, we are satisfied that the conspiracy count in the original indictment covered not only Davis's control activities, [FN7] but also transactions including (1) the acquisition of FNBE with $12.5 million of debt, $3.1 million of which was diverted to Davis and Anderson, [FN8] (2) GFB's purchase of subordinated debentures and preferred stock from EVCO and SSBC, with certain proceeds diverted to Burke and Davis, [FN9] (3) the Elkhorn land deal and Davis's $500,000 commission appearing in the false GFB minutes, [FN10] (4) the Dakota Minerals transactions in which Davis and Burke had a secret interest, [FN11] and (5) the loan to Tired Iron, Inc. based on misvalued security. [FN12] Thus, Davis had prior notice of the conspiracy charged in the superseding indictment. Indeed, after a practical reading of the counts in question in each indictment, we must conclude "that essentially the same facts were used to charge almost identical offenses." See United States v. Charnay, 537 F.2d 341, 355 (9th Cir.), cert. denied, 429 U.S. 1000, 97 S.Ct. 528, 50 L.Ed.2d 610 (1976). The wire fraud counts remained the same, and the conspiracy charge (which ***1492** contained a description of the fraudulent scheme alleged in the wire fraud counts) was not materially different. See Grady, 544 F.2d at 602. Therefore, we must reject Davis's contention that counts 2-10 were time-barred.

FN7. See I R. doc. 1 at 7, ¶ 1; 10, ¶ 10; 17, ¶ 18.

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FN8. See I R. doc. 1 at 7-10, ¶¶ 3-7; 12-16, ¶¶ 1, 2, 4, 6-14.

FN9. See I R. doc. 1 at 10-11, ¶¶ 10 & 12; 18-21, ¶¶ 21-34.

FN10. See I R. doc. 1 at 11, ¶ 11; 21-22, ¶¶ 35-36.

FN11. See I R. doc. 1 at 11-12, ¶ 13; 26, ¶¶ 48-49.

FN12. See I R. doc. 1 at 24, ¶ 43.

III.

[13][14][15][16] Defendant contends that the district court erred in not submitting his "theory of the defense" instructions and instructing the jury that if the money invested by GFB in the subordinated debentures and preferred stock was used by the recipient corporations in the way promised to GFB, there could be no misapplication. [FN13] A defendant is entitled to correct instructions on defenses supported by sufficient evidence for a jury to find in defendant's favor. Mathews v. United States, 485 U.S. 58, 63, 108 S.Ct. 883, 887, 99 L.Ed.2d 54 (1988); Ratchford, 942 F.2d at 707. Still, a district judge has substantial discretion in formulating the instructions; our review is confined to determining whether the instructions as a whole sufficiently cover the issues presented by the evidence and constitute correct statements of the law. United States v. Pena, 930 F.2d 1486, 1492 (10th Cir.1991). Instructions are considered as a whole; a particular jury instruction is not be read in isolation. See Cupy v. Naughten, 414 U.S. 141, 146-47, 94 S.Ct. 396, 400, 38 L.Ed.2d 368 (1973).

FN13. The proposed instruction stated: No misapplication of bank funds results where the recipient of bank funds uses them for the very purpose for which the funds were disbursed. IV R. doc. 314.

Davis's "theory of the case" instructions are essentially summaries of the evidence in the light most favorable to the defense, [FN14] summaries more appropriate for closing argument. The trial judge's decision not to give such instructions was proper in every respect. See United States v. Barham, 595 F.2d 231, 245 (5th Cir.1979) ("theory of the defense" instruction properly refused when it "was essentially a recounting of the facts as seen through the rose-colored glasses of the defense--glasses [defendant] hoped the jury would wear when they retired to the jury room"). These summaries marshal facts supporting Davis's version of the events, and would preclude the jury from finding the elements of various charged offenses. After review of the court's instructions to the jury, we note that they adequately (and with commendable clarity) cover the essential elements of every offense charged and encompass Davis's defenses supported by the evidence such as reliance on expert advice, good faith, and approval by bank officials after adequate disclosure. See, e.g., IV R. doc. 332, instr. 21, 22, 23, 24, 25, 26, 27, 28, 30, 31, 32, 34, 36, 52 & 53.

FN14. See, e.g., Defendant Davis's Instruction No. [unnumbered] .... COUNT 1: Mr. Davis did not enter into an agreement with Dan Burke, John Edmiston or anyone else to commit criminal acts. While the government claims that he conspired to control three banks, the evidence clearly showed that Mr. Davis was attempting to sell his interest as required by government regulators. Davis's attempts to comply are being unfairly and improperly used against him. .... IV R. doc. 314.

[17] The other challenge concerns the district court's rejection of Davis's instruction concerning misapplication. Davis relies upon United States v. Payne, 750 F.2d 844 (11th Cir.1985), in which the court of appeals set aside misapplication convictions because the government failed to prove that the borrowers for whom the defendants arranged loans were not creditworthy, nor did the government prove the loans undersecured. Id. at 750 F.2d at 856-57. Payne does not support Davis's argument.

[18][19] Misapplication of bank funds under § 657 involves: "(1) the willful (2) misapplication (3) of money, funds or credits (4) of a federally protected bank." United States v. Harenberg, 732 F.2d 1507, 1511 (10th Cir.1984) (construing 18 U.S.C. § 656); [FN15] United States v. Twiford, ***1493** 600 F.2d 1339, 1343 (10th Cir.1979) (same). Misapplication may occur when an officer, director, employee or other person subject to the statute knowingly lends money to a sham borrower or causes all or part of the loan to be made for his own

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benefit while concealing his interest from the bank. Twiford, 600 F.2d at 1341-42. Misapplication of funds " 'occurs when funds are distributed under a record which misrepresents the true state of the record with the intent that bank officials, bank examiners, or the Federal Deposit Insurance Corporation will be deceived.' " Id. at 1341 (quoting United States v. Kennedy, 564 F.2d 1329, 1339 (9th Cir.1977), cert. denied, 435 U.S. 944, 98 S.Ct. 1526, 55 L.Ed.2d 541 (1978)). Thus, when a person within the ambit of § 657 receives material benefits of loans without disclosing this fact, misapplication has occurred. See United States v. Cooper, 464 F.2d 648, 651-52 (10th Cir.1972) (construing 18 U.S.C. § 656).

FN15. Section 656 is a parallel statute to § 657, whereas § 656 protects institutions insured by FDIC, § 657 protects institutions insured by FSLIC. United States v. White, 882 F.2d 250, 253 (7th Cir.1989).

The proffered instruction would have narrowed the test, instructing the jury that if a recipient of bank funds uses them for the purpose intended, misapplication cannot occur. This is an incorrect statement of the law. A borrower of funds may use them for the purpose intended, yet the bank insider (who may or may not be aided and abetted by the borrower) may not disclose other material facts surrounding the extension of credit, such as adverse borrower characteristics, inadequate collateral or self-dealing, and, therefore, commit misapplication of funds. See Payne, 750 F.2d at 856; United States v. Riebold, 557 F.2d 697, 700-01 (10th Cir.), cert. denied, 434 U.S. 860, 98 S.Ct. 186, 54 L.Ed.2d 133 (1977). Indeed, we have recognized that misapplication may occur when the funds are applied by the borrower for the very purpose intended, yet the bank insider has failed to disclose his interest in the transaction. See Twiford, 600 F.2d at 1340-41.

In Twiford, a bank officer and director made a $20,000 loan to a construction company president for operating expenses. The bank officer also indicated to the borrower that the officer knew someone that would cosign a construction bond for a $6,500 fee. A loan for $26,500 loan was made, and the proceeds applied to the borrower's satisfaction. The cosigning fee was paid to a fictitious party and "the jury concluded that through a series of transactions the sum had been channeled to defendant [bank officer]." Id. at 1341. Such lack of disclosure constituted misapplication.

[20] The theory underlying defendant Davis's proffered instruction is "that the money invested by GFB in subordinated debentures and preferred stock was used by the recipient corporations [SSBC and EVCO] in exactly the fashion promised to GFB [to invest in WFS] and, thus, there could be no misapplication." Davis's Brief at 26. The proffered instruction would have made irrelevant Davis's undisclosed self-dealing when it came to GFB's investment in the securities in question and thus was improper. Moreover, the trier of fact is not restricted solely to the immediate transferee of bank funds when determining whether misapplication has occurred. See Harenberg, 732 F.2d at 1511.

IV.

Davis argues that the district court should have granted a new trial because various counts of the indictment were faulty. Presumably, Davis seeks a new trial absent the evidence used to prove the allegedly faulty counts.

A.

[21] Davis contends that counts 11, 12 and 13 of the superseding indictment should have been dismissed. These counts charged Davis with willful misapplication of bank funds with respect to GFB's purchase of subordinated debentures in EVCO and SSBC, and PRSC's (a wholly-owned subsidiary of GFB) purchase of preferred stock in SSBC. The substance of Davis's argument is that Davis could not misapply funds "belonging to or intrusted in the care of" GFB. He points out that GFB invested the funds in bank holding companies (SSBC ***1494** and EVCO), and the bank holding companies then spent only a portion of the funds to acquire an option in WFS. WFS then paid substantial sums to Burke and Davis.

Davis contends that these counts must be dismissed for three reasons: (1) he was not within the class to which 18 U.S.C. § 657 applies, (2) the grand jury did not indict him for misapplication of funds belonging to WFS, but rather belonging to GFB, and (3) as a matter or law, funds belonging to WFS cannot belong to GFB and cannot be the

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subject of misapplication counts 11-13.

We have rejected the first reason as discussed above. The second reason concerning the sufficiency of the indictment is without merit. Counts 11-13 incorporate by reference allegations in the conspiracy count indicating that the money was diverted to personal use through WFS; thus, the grand jury indicted on this theory. See II R. doc. 146 at 8, ¶¶ 13 & 15.

[22][23] The third reason, that GFB funds were not involved, is foreclosed by any number of authorities, including United States v. Harenberg, in which Judge Barrett, writing for the court, eloquently and firmly rejected such a grudging interpretation of § 656. First, GFB's decision to purchase these securities in amounts which exceeded the legitimate uses of these funds constituted misapplication of GFB's bank funds. [FN16] Harenberg, 732 F.2d at 1511; United States v. Farrell, 609 F.2d 816, 819 (5th Cir.1980). "The statute does not require that cash actually leave the bank before a violation occurs." Farrell, 609 F.2d at 819. Davis's concealed interest in these funds "did not suddenly materialize after the bank funds were disbursed to the borrowers; rather it existed well before." See Harenberg, 732 F.2d at 1511. Second, recognizing the infinite imagination for evil, see Genesis 6:5, including methods for misapplication of bank funds by those familiar, see Payne, 750 F.2d at 856, we have declined to apply the statute solely on "the flow of funds and the consequent changes in the incidence of ownership." Harenberg, 732 F.2d at 1511. Rather, we look at the substance of the transactions, even if multiple entities are involved. Twiford, 600 F.2d at 1341. It seems to us that Davis's invitation to apply the statute based solely on the exchange of property rights (e.g. subordinated debentures and preferred shares exchanged for cash), without regard to the concealed information and the substance of the transactions, is exactly the approach rejected in Harenberg, one which would "miss the forest for the trees." See Harenberg, 732 F.2d at 1511. Davis's attempt to distinguish Harenberg and Twiford as involving kickbacks to bank officers and directors is unavailing in light of our previous rejection of such a limited approach.

FN16. See VIII R.S. 31 which illustrates the wisdom of this construction: Mr. Pico: Mr. Hogan, had you known that Mr. Davis was going to obtain a substantial portion of the monies from the subordinated debentures and preferred shares, would you have invested those in behalf of Guaranty Federal Bank? Mr. Hogan: No. It matters not that Mr. Hogan viewed the investments as prudent at the time made; such view was based in part on material misinformation. Davis further argues that to the extent that the allegedly misapplied funds came from PRSC, a wholly-owned subsidiary of GFB, such funds are beyond the reach of § 657 because PRSC was not a federally insured institution. Davis relies upon United States v. White, 882 F.2d 250 (7th Cir.1989), which involved allegedly false statements made to a wholly-owned equipment leasing subsidiary of a federally protected bank under 18 U.S.C. § 1014. We view White as turning on a failure of proof; the government did not prove that the defendant knew that the false statements made to the subsidiary would affect the parent bank. See Id. at 254. The evidence indicates that PRSC never received the funds provided by GFB, rather, those funds were disbursed from GFB to SSBC and EVCO. Moreover, even had the funds passed from GFB through PRSC, ample proof indicates that the funds belonged to GFB or that PRSC was merely a conduit through which Burke and Davis exploited GFB. See id. at 253; Prater, 805 F.2d at 1446; United States v. Fulton, 640 F.2d 1104, 1105-06 (9th Cir.1981); United States v. Cartwright, 632 F.2d 1290, 1292-93 (5th Cir.1980); Sell v. United States, 336 F.2d 467, 472 (10th Cir.1964).

B.

[24] Davis next argues that the district court should have dismissed count 18 which ***1495** charged him with overvaluing security by submitting a false appraisal report. Davis argues that because the appraisal report was not received by GFB until almost one year after the loan was made and after the note matured, [FN17] the appraisal report as a matter of law could not be for the purpose of influencing GFB to approve a loan to Tired Iron, Inc., as alleged in the indictment. He also claims that the airplane parts appraised were not collateral for the loan and that he did not in any way submit the appraisal to GFB.

FN17. The note may have matured, but it was not paid. XIV R.S. 35.

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Viewed in the light most favorable to the government, sufficient evidence supports the charge that Davis was responsible for submitting the appraisal report to GFB and that the report valued the collateral for the $650,000 loan in question. GFB sought the appraisal as a condition of the initiation and continuation of the loan. Pl. ex. 747, 1260. Johnson, who prepared the appraisal, did so at the behest of Davis. XXXIII Tr. 29. Mike Brown, the executive vice-president of GFB, testified that the appraisal was part of GFB's records pertaining to Tired Iron, Inc., as a borrower. XIV R.S. 45. The jury could logically infer that Davis provided the late appraisal report incident to GFB's extension of credit. Having so determined, it is of no moment that the inflated appraisal report was furnished subsequent to the loan advance. United States v. Kindig, 854 F.2d 703, 706 (5th Cir.1988); United States v. Gardner, 681 F.2d 733 (11th Cir.1982); United States v. Baity, 489 F.2d 256, 257 (5th Cir.1983). The government was not required to prove that GFB actually relied upon the appraisal. See United States v. Goberman, 458 F.2d 226, 229 (3rd Cir.1972).

C.

[25] Davis contends that count 21 should have been dismissed because it alleges that on or about September 28, 1984, Davis and Burke made and caused to be made false entries in GFB minutes of October 3, 1984. According to Davis, "[i]t is factually and legally impossible for defendant Davis or any person to cause the falsification of a future wholly independent event." Davis's Brief at 34.

Under 18 U.S.C. § 1006, the government was required to prove that "(1) defendant made a false entry in bank records, caused it to be made, or aided and abetted its entry; (2) defendant knew the entry was false when it was made; and (3) defendant intended that the entry injure or deceive a bank or public official." United States v. Wolf, 820 F.2d 1499, 1504 (9th Cir.1987), cert. denied, 485 U.S. 960, 108 S.Ct. 1222, 99 L.Ed.2d 423 (1988) (construing 18 U.S.C. § 1005); United States v. Jackson, 621 F.2d 216, 219 (5th Cir.1980) (same). Although Davis contends that the events of September 28 and October 3 are wholly independent, such is not the case. To the contrary, Burke and Davis met with Ron Brown, attorney for GFB, on September 28, 1984, after inquiries by federal regulators, including inquiries about the Elkhorn land deal. XXX Tr. 37-41, 69, 140, 145, 155-56; 184-88; Pl. ex. 1170. The meeting was designed to respond to those inquiries, and therefrom would come the false minutes of October 3, 1984. Burke sat on the board which approved the minutes, although he abstained on the vote concerning the fraudulent amendment. The false entry in the October 3 minutes had its genesis in the September 28 meeting; a reasonable jury could conclude beyond a reasonable doubt that Davis knowingly aided and abetted Burke in creating a false bank record, all in an effort to satisfy federal regulators concerning the previously unmentioned $500,000 Elkhorn commission paid to Davis. It is sufficient that Davis knowingly "set into motion" or knowingly participated in events which would necessarily cause the false entries to be made. See Wolf, 820 F.2d at 1504; United States v. Krepps, 605 F.2d 101, 109 n. 28 (3rd Cir.1979).

V.

[26][27] Davis next argues that the indictment should be dismissed or evidence suppressed because of government agency deception. Specifically, Davis contends ***1496** that the Federal Reserve Board (FRB), the Federal Home Loan Bank Board (FHLBB) and the Office of Comptroller of Currency (OCC) violated the Right to Financial Privacy Act (RFPA), 12 U.S.C. §§ 3401-3422, when, beginning in August 1984, these agencies (along with the Wyoming State Examiner's Office) exchanged information and transferred financial records pertaining to Davis's bank transactions. Davis's Brief at 35-36. In response to a similar argument by Davis in a civil enforcement proceeding, we held that RFPA was not violated by the FRB requested information from the above supervisory agencies in pursuit of its supervisory responsibilities. Burke, 940 F.2d at 1368. We are satisfied that the above agencies acted within their supervisory capacities [FN18] in securing and exchanging information concerning Davis's activities with respect to bank holding companies and individual banks. [FN19] See 12 U.S.C. §§ 3401(7), 3412(d), & 3413(b). Therefore, we must conclude that RFPA did not apply to the information disclosed by these agencies concerning Davis's bank transactions. See Burke, 940 F.2d at 1368; Adams v. Board of Governors, 855 F.2d 1336, 1345 (8th Cir.1988). Moreover, even had the RFPA been violated, we agree with the

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district court that suppression is not an available remedy, nor is dismissal of an indictment. See LVI Tr. 81; 12 U.S.C. § 3417(d); United States v. Miller, 425 U.S. 435, 442-43, 96 S.Ct. 1619, 1624, 48 L.Ed.2d 71 (1976); United States v. Kingston, 801 F.2d 733, 737 (5th Cir.1986), cert. denied, 481 U.S. 1014, 107 S.Ct. 1888, 95 L.Ed.2d 495 (1987); United States v. Frazin, 780 F.2d 1461, 1464-66 (9th Cir.), cert. denied, 479 U.S. 844, 107 S.Ct. 158, 93 L.Ed.2d 98 (1986).

FN18. SSBC and EVCO were regulated by the FRB; FNBE by the OCC; SSB by the FDIC and the Wyoming State Examiner's Office; and GFB by the FHLBB.

FN19. We note that an additional exception to RTPA now in effect, 12 U.S.C. § 3413(l), would encompass the disclosures in this case.

[28] Davis next contends that the FRB induced him participate in a meeting on June 7, 1985, to discuss financial problems of SSBC and EVCO, without revealing to him that, two days earlier, the FRB had sent a criminal referral to the United States Attorney. The criminal referral identified "eight or nine insiders" of SSBC and EVCO as the targets. The referral was drafted not later than May 2, 1985, but was not received by the U.S. Attorney until June 10, 1985. Def. ex. 2038, 2039. Davis seeks suppression of statements made during the meeting or dismissal of the indictment.

The district court denied a suppression motion concerning statements from an earlier FRB meeting in which Davis participated, along with other bank officers. XLI Tr. 93, 105-08. The district court determined that no custodial interrogation was involved. The June 7, 1985, meeting also involved the boards of directors from EVCO and SSBC and various Federal Reserve System personnel. Ron Brown was present and was representing Davis, as well as other directors. The purpose of the June 7, 1985, meeting was to present cease and desist orders to EVCO, SSBC and various individuals. XLI Tr. 133. The Federal Reserve System attorney, who had worked on the criminal referral, indicated that written plans submitted by the boards in response to the consent orders would be accepted if reasonable, and that "the Fed was trying to obtain remedial rather than punitive actions." Pl. ex. 809 at 1; XLI Tr. 159, 161-62.

Also discussed were various supervisory issues, raised at the earlier meeting, which are material to the criminal prosecution. For example, Davis was asked the whereabouts of $475,000 supplied by the holding companies to WFS. XLI Tr. 134. He referred his questioner to the books of WFS. Id. Likewise, in response to questions, Davis stated that he was not a shareholder, officer or director of WFS, but did receive consulting fees. Id. He also indicated that he had attended EVCO board meetings. Pl. ex. 809 at 3. Despite the potential overlap between the civil and criminal cases, Maryann Hunter of the Federal Reserve testified that "we were trying to correct the problems on the supervisory issues that we had through our civil type actions in a remedial type of way." XLI Tr. 161.

***1497** There is no proof of custodial interrogation at the June 7, 1985, meeting. Accordingly, the safeguards of the Fifth Amendment, as interpreted in Miranda v. Arizona, 384 U.S. 436, 86 S.Ct. 1602, 16 L.Ed.2d 694 (1966), were unnecessary. See Beckwith v. United States, 425 U.S. 341, 347-48, 96 S.Ct. 1612, 1617, 48 L.Ed.2d 1 (1976) (Miranda warnings not required during noncustodial interview pursuant to criminal tax investigation). Moreover, in denying the closely related suppression motion concerning statements made at the earlier meeting, the district court implicitly rejected the idea that the June 7, 1985, meeting was part of "a pattern of trickery on behalf of the government," XLI Tr. 103, in which the government was using the administrative process to obtain criminal information. See XLI Tr. 108. This implicit finding is not clearly erroneous.

[29] A government agency charged with bank oversight may well develop information in civil matters which may be relevant in a potential criminal prosecution. United States v. Copple, 827 F.2d 1182, 1189 (8th Cir.1987), cert. denied, 484 U.S. 1073, 108 S.Ct. 1046, 98 L.Ed.2d 1009 (1988). Although the agency did not tell the parties concerning the referral, Davis has not come forward with evidence on his due process claim indicative of either (1) reasonable reliance on this deliberate omission, or (2) prejudice resulting from such reliance. See United States v. Caceres, 440 U.S. 741, 752-53, 99 S.Ct. 1465, 1472, 59 L.Ed.2d 733 (1979); Cox v. Louisiana, 379 U.S. 559, 573, 85 S.Ct. 476, 485, 13 L.Ed.2d 487 (1965). Accordingly, we reject it just as the district court

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apparently did.

VI.

[30][31] Davis next argues that he should have received a new trial based upon prosecutorial misconduct, specifically a sentencing memorandum filed by the government. See V R. Doc. 355. Although we see many a thin argument at the court of appeals, we are hard pressed to determine how the sentencing memorandum (postverdict) would require a new trial, even if it did net the government some press coverage. See V R. doc. 357, ex. A. In any event, we reject the notion that Fed.R.Crim.P. 32(a)(1), which provides that "[t]he attorney for the government shall have an equivalent opportunity to speak to the court," precludes the filing of a written sentencing memorandum. [FN20] For instances of such memoranda being filed by the government, see United States v. Ruminer, 786 F.2d 381, 385-86 (1986) and United States v. Salas, 824 F.2d 751, 752-53 (9th Cir.), cert. denied, 484 U.S. 969, 108 S.Ct. 465, 98 L.Ed.2d 404 (1987). Only if the government's sentencing memorandum is incorporated expressly into the presentence report and the defendant objects to material contained in the memorandum, would compliance with Fed.R.Crim.P. 32(c)(3)(D) (objections to the presentence report) be necessary. Salas, 824 F.2d at 753.

FN20. No common law right of allocution existed for the government. See 3 Charles A. Wright, Federal Practice & Procedure-Criminal § 525 at 87 (1982). The provision in Rule 32 was added in 1975 and requires that the government attorney be heard, if he so chooses. Id.

VII.

[32][33][34] Defense counsel requests a writ of mandamus requiring the district court to process his interim vouchers for payment of fees and expenses pursuant 18 U.S.C. § 3006A. [FN21] Counsel was appointed over his objection on March 23, 1988, and represents that he has yet to receive any interim payments, despite compliance with the district court's order on the subject, which was approved by the Chief Judge of the Tenth Circuit. See VII Administrative Office of the United States Courts, Guide to Judiciary Policies & Procedures app. E ***1498** (interim payments to counsel). In seeking mandamus, however, we note that counsel has not complied with Fed.R.App. 21(a) concerning the requirement of filing a separate petition and proof of service on the respondent judge, as well as other parties below. We therefore deny the request, but without prejudice to a properly filed and served petition. [FN22]

FN21. Fee determinations by the district judge pursuant to the Criminal Justice Act are administrative in character and do not constitute final appealable orders within the meaning of 28 U.S.C. § 1291. United States v. Rodriguez, 833 F.2d 1536, 1537-38 (11th Cir.1987); United States v. Walton (In re Baker), 693 F.2d 925, 926-27 (9th Cir.1982); United States v. Smith, 633 F.2d 739, 741-42 (7th Cir.1980), cert. denied, 451 U.S. 970, 101 S.Ct. 2047, 68 L.Ed.2d 349 (1981). 18 U.S.C. § 3006A(d)(4) requires that the district court "shall fix the compensation and reimbursement to be paid to the attorney" given a properly supported claim. The district court's order indicates that the district judge "will review the interim vouchers when submitted ... and will authorize compensation to be paid" and "payment [of] all reimbursable expenses." I R. doc. 101 at 2. The district judge will also review the final voucher and submit to the chief circuit judge for review and approval. Id. Here, counsel claims that the district court has not complied with its duty to review CJA vouchers and forward them for payment. We view this as fundamentally different from claims concerning the amount of payment and, therefore, conclude that the matter is cognizable under 28 U.S.C. § 1651(a).

FN22. Defense counsel also suggests that a new trial may be warranted if the failure to pay "resulted in an abrogation of Mr. Davis's rights." Davis's Brief at 45. After painstaking review of the proceedings below and in this court, we confidently state that no such abrogation has occurred. A new trial on this ground is not warranted.

Defendant Burke's appeal is DISMISSED. The criminal judgment against defendant Burke is REMANDED to the district court with instructions to VACATE it and DISMISS the underlying indictment against him. The criminal judgment against defendant Davis is AFFIRMED. The request of Davis's counsel for the writ of mandamus to issue is DENIED without prejudice to a proper application. All pending motions are DENIED.

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misappl— jury instr. & elements.

UNITED STATES of America, Plaintiff-Appellee,
v.
Robert L. BAILEY, Kevin Kehoe, Robert M. Lang, and Harold J. Ticktin,
Defendants-Appellants.

Nos. 86-2963 to 86-2965, 86-2982.

United States Court of Appeals,
Seventh Circuit.

Argued June 3, 1988.

Decided Sept. 22, 1988.

Defendants were convicted of mail fraud for their roles in schemes to defraud the Federal Home Loan Bank Board, the Federal Savings and Loan Insurance Corporation, and shareholders and depositors of particular savings and loan, and one of the defendants was also convicted of violating RICO statute, misapplying funds of federally insured savings and loan, and conspiring to misapply funds. On appeal by defendants after the United States District Court for the Northern District of Illinois, Eastern Division, 675 F.Supp. 1109, Nicholas J. Bua, J., denied defendants' motion to vacate their convictions and dismiss charges against them, the Court of Appeals, Manion, Circuit Judge, held that: (1) evidence would not support finding two of the defendants intended to defraud FHLBB, FSLIC, or savings and loan's depositors and shareholders; (2) indictment charging mail fraud sufficiently alleged conduct that violated mail fraud statute, although charges were couched in intangible rights language, as trial evidence and arguments, along with jury instructions, established that jury necessarily found defendant's schemes were aimed at victims' property rights, so as to make mail fraud convictions proper; and (3) evidence regarding defendant savings and loan's president's acceptance of bonuses and making of loans supported convictions for misapplying savings and loan's funds based on his conduct.

Reversed in part; affirmed in part; and remanded with instructions.

[1] POSTAL SERVICE ⇐ 49(11)
306k49(11)
Evidence would not support conviction for mail fraud in connection with condominium transaction, on indictment counts that alleged mailing of recorded mortgages from recorder of deeds to savings and loan institution as the mailing; similar mailings had previously been held insufficient to support defendant's conviction for mail fraud in connection with that part of condominium transaction financed by bank, and the mailings alleged in instant case were indistinguishable from those alleged in that other case.

[2] CRIMINAL LAW ⇐ 1030(3)
110k1030(3)
Although codefendant did not challenge sufficiency of mailings to sustain conviction on mail fraud counts in his opening appellate brief, it would be plain error to affirm codefendant's conviction on those counts while holding they failed against defendant, and codefendant's convictions on those counts would accordingly be reversed.

[3] CRIMINAL LAW ⇐ 1190
110k1190
Reversing three mail fraud convictions against defendant did not automatically require reversal of defendant's convictions on all counts in indictment under which defendant had been convicted of mail fraud for his role in schemes to defraud Federal Home Loan Bank Board, Federal Savings and Loan Insurance Corporation, and shareholders and depositors of savings and loan corporation of which defendant was president, and also convicted for violating RICO statute, misapplying funds of federally insured savings and loan, and conspiring to misapply funds; all the indictment's counts were properly joined, there was no basis for severance, the indictment's charges were all of similar character and arose from same overall scheme to loot savings and loan, and most, if not all, of the evidence admitted on counts with respect to which convictions were reversed would have been admitted absent those counts. Fed.Rules Cr.Proc.Rules 8(a), 14, 18 U.S.C.A.

[4] POSTAL SERVICE ⇐ 35(5)
306k35(5)
To convict defendants of mail fraud, Government could not simply show that they participated in transaction which turned out to be part of fraudulent scheme, but rather, Government also had to show defendants' willful participation in scheme with knowledge of its fraudulent nature and with intent

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that illicit objectives be achieved.

[5] POSTAL SERVICE ⇐ 49(11)
306k49(11)
Evidence was not sufficient to prove defendants intended to defraud Federal Home Loan Bank Board, Federal Savings and Loan Insurance Corporation, or shareholders and depositors of savings and loan corporation, and would thus not support mail fraud convictions, even under "ostrich" instruction, that jury could infer knowledge from combination of suspicion and indifference to the truth, although defendants borrowed money and exercised their irrevocable options to tender collateral back to lender savings and loan on the same day, and made $5,000 for their efforts; highly regarded and respected real estate brokers assured defendant borrowers the deal was legitimate, and the defendant borrowers also had the savings and loan's president's assurance, implied through his participation, that the transaction was legitimate.

[6] POSTAL SERVICE ⇐ 48(4.1)
306k48(4.1)
Formerly 306k48(4.8)
Indictment counts charging mail fraud sufficiently alleged mail fraud offenses, although each specific charge was couched in intangible rights language, and the Supreme Court had rejected the intangible rights theory of mail fraud, holding that the statute makes criminal only schemes intended to deprive people of property rights; substantive allegations in each count charged scheme that had substantial potential to take other people's property by fraud, alleging that savings and loan institution was in precarious financial position, and that defendant president artificially inflated savings and loan's net worth, and alleged acts by president that defrauded savings and loan's shareholders and depositors out of their property interests by committing funds to loans, depriving savings and loan of down payments it would otherwise have received, and paying savings and loan's funds to confederate for commissions.

[7] CRIMINAL LAW ⇐ 1134(2)
110k1134(2)
To determine whether defendant's mail fraud convictions could stand, where indictment alleged intangible rights fraud, which Supreme Court had rejected as theory of mail fraud, as well as substantive allegations charging scheme with substantial potential to take other people's property by fraud, which did state offenses under Supreme Court decision, Court of Appeals had to examine jury instructions, along with evidence and arguments at trial, to see if jury necessarily convicted defendant of conduct that constituted an offense.

[8] CRIMINAL LAW ⇐ 1167(1)
110k1167(1)
Trial evidence and arguments, along with jury instructions, established that jury necessarily found on mail fraud charges that defendant's schemes were aimed at his victims' property rights, rather than at intangible rights, and convictions of mail fraud offenses would thus be sustained, although Supreme Court had rejected intangible rights theory of mail fraud and indictment counts did allege scheme to defraud persons of their intangible rights, as well as alleging scheme with substantial potential to take other people's property by fraud.

[9] RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ⇐ 19
319Hk19
Formerly 83k82.71
Defendant's RICO conviction would be upheld, where the RICO count alleged substantive mail fraud counts as predicate offenses, and some of defendant's mail fraud convictions had been upheld, although other of his mail fraud convictions had been reversed; jury had no discretion to pick and choose among predicate offenses. 18 U.S.C.A. §§ 1962, 1963.

[10] EMBEZZLEMENT ⇐ 23
146k23
Consent to award of bonuses to president of savings and loan institution by savings and loan's board of directors was not complete defense to charges defendant president misapplied savings and loan's funds. 18 U.S.C.A. § 657.

[11] EMBEZZLEMENT ⇐ 23
146k23
Although consent by board of directors is important factor to consider in determining whether defendant attempted to defraud savings and loan institution, if intent to defraud or injure exists, board of directors' approval is irrelevant, for purposes of statute proscribing misapplication of savings and loan's funds. 18 U.S.C.A. § 657.

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[12] EMBEZZLEMENT ⚿ 23
146k23
Acting in official capacity in accepting salary and bonuses would not be complete defense for defendant president of savings and loan institution to charge of misapplication of savings and loan's funds. 18 U.S.C.A. § 657.

[13] EMBEZZLEMENT ⚿ 48(1)
146k48(1)
Defendant, the president of savings and loan institution, charged with misapplication of savings and loan's funds based on his acceptance of bonuses from savings and loan was not entitled to more than instructions given on approval by board of directors and acting in official capacity as theories of defense and opportunity to argue those points to jury; he was not entitled to proposed instructions, which did not correctly state law, that would have made board's consent to bonuses complete defense and would have made defendant's acting in official capacity in accepting salary and bonuses complete defense. 18 U.S.C.A. § 657.

[14] EMBEZZLEMENT ⚿ 44(1)
146k44(1)
Evidence supported convicting president of savings and loan institution for misapplication of savings and loan's funds through acceptance of bonuses; evidence permitted finding president embarked on series of fraudulent schemes to keep savings and loan artificially alive and permitted finding president was able to receive bonuses because of his pattern of fraudulent conduct, and bonuses were awarded to president at time when he knew savings and loan had negative net worth. 18 U.S.C.A. § 657.

[15] EMBEZZLEMENT ⚿ 4
146k4
Under statute proscribing misapplication of funds of savings and loan, although lack of collateral, by itself, did not make loan made by bank officer misapplication of funds, unsecured or undersecured loan could be misapplication of funds, if made with intent to defraud or injure bank. 18 U.S.C.A. § 657.

[16] EMBEZZLEMENT ⚿ 48(1)
146k48(1)
Proposed instruction in prosecution of savings and loan institution's president for misapplication of funds based on loans defendant president had made, that it was not misapplication for bank officer to make loan with little or no collateral, would have focused jury's attention solely on lack of collateral and away from other facts from which jury could have inferred intent to defraud or injure savings and loan, and the instruction was thus properly refused. 18 U.S.C.A. § 657.

[17] EMBEZZLEMENT ⚿ 4
146k4
Under statute proscribing misapplication of funds of savings and loan, when bank officer makes loan knowing that named borrower will turn proceeds over to third party for the officer's own ultimate benefit, he has made a criminal misapplication of funds, regardless of named borrower's intent or ability to repay the loan. 18 U.S.C.A. § 657.

[18] EMBEZZLEMENT ⚿ 4
146k4
If all facts and circumstances surrounding particular loan indicate that bank officer intended to defraud or injure bank by making loan, jury may then properly find that the loan was criminal misapplication of funds despite named borrower's willingness and ability to repay it; intent to defraud or injure bank is what separates criminal misapplication of funds from mere maladministration. 18 U.S.C.A. § 657.

[19] EMBEZZLEMENT ⚿ 44(1)
146k44(1)
Evidence supported convicting president of savings and loan institution of misapplication of savings and loan's funds with respect to five loans; one loan benefited president and was clever way for him to circumvent regulations prohibiting from loaning himself money from savings and loan, second loan could be seen as benefiting president by allowing himself to pay off personal obligation with savings and loan's money, third and fourth loans went to pay part of another loan third person used in part to pay off president's obligation, and fifth loan was made to person who never met with loan officer and was paid $6,000 to participate in loan transaction, and charges were tried and argued as part of overall theory that president concocted several fraudulent schemes designed to build savings and loan a substantial amount of its assets. 18 U.S.C.A. § 657.

[20] EMBEZZLEMENT ⚿ 26
146k26

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Indictment counts alleging misapplication of funds of savings and loan institution by president of savings and loan, through acceptance of bonuses and through making of loans, did sufficiently state offenses; each count alleged that defendant was officer of savings and loan, that savings and loan was federally insured, that defendant willfully misapplied savings and loan's funds and how he misapplied those funds, and that defendant acted with intent to injure or defraud savings and loan. 18 U.S.C.A. § 657.

[21] CRIMINAL LAW ⇐ 1169.11
110k1169.11
Even if testimony of savings and loan institution's in-house attorney, that defendant president of savings and loan billed services in-house attorney performed for confederate at the defendant's request under letterhead of defendant's private law firm, were evidence of other acts to prove character of person to show action conforming therewith in violation of evidence rule, admission of the testimony was not reversible error; evidence was admissible as relevant to conspiracy count and other counts involving defendant and confederate because it showed nature of relationship between them, and any potential for unfair prejudice to defendant was minimal. Fed.Rules Evid.Rule 404(b), 28 U.S.C.A.

[22] CRIMINAL LAW ⇐ 1166(10.10)
110k1166(10.10)
proceedings.
Even if admission of testimony violated district court's prior disclosure order, defendant had not mentioned how that violation affected his defense or prejudiced him in any way, and admission of the testimony was thus not reversible error. Fed.Rules Evid.Rule 103(a), 28 U.S.C.A.

***1268** Barry A. Spevack, Monico & Pavich, Robert A. Fisher, Frazin & Fisher, Michael D. Hayes, Holleb & Coff, Chicago, Ill., for defendants-appellants.

***1269** Chris G. Gair, Asst. U.S. Atty., Anton R. Valukas, U.S. Atty., Chicago, Ill., for plaintiff-appellee.

Before EASTERBROOK and MANION, Circuit Judges, and GORDON, Senior District Judge. [FN*]

FN* The Honorable Myron L. Gordon, Senior District Judge for the Eastern District of Wisconsin, is sitting by designation.

MANION, Circuit Judge.

A jury convicted Harold Ticktin, Kevin Kehoe, Robert Bailey, and Robert Lang of mail fraud, 18 U.S.C. § 1341, for their roles in various schemes to defraud the Federal Home Loan Bank Board (FHLBB), the Federal Savings and Loan Insurance Corporation (FSLIC), and the shareholders and depositors of Manning Savings and Loan Corporation, a now-defunct savings and loan in Chicago. The jury also convicted Ticktin on one count of violating the RICO statute, 18 U.S.C. §§ 1962 and 1963, various counts of misapplying the funds of a federally insured savings and loan, 18 U.S.C. § 657, and one count of conspiracy to misapply funds, 18 U.S.C. § 371. We affirm in part and reverse in part.

I.
Facts

The evidence, taken in the light most favorable to the government, reveals that Ticktin was the President of Manning Savings and Loan Corporation, a state-chartered savings and loan insured by the FSLIC. Ticktin was also a member of Manning's Board of Directors and a shareholder in Manning, as well as President of Manning's wholly-owned subsidiaries, Manning Service Corporation and Manning Production Corporation.

During 1980 and 1981, Manning's net worth began to decline; by April, 1981, Manning's net worth was below the minimum level set by federal regulations, and still declining. Federal regulators met with Ticktin and the Manning Board of Directors several times during the Spring of 1981 to discuss the problem. During these meetings, the federal regulators advised Manning that the 1980 dividend the board had declared was inappropriate because of Manning's decreasing net worth. The regulators asked the board to refrain from declaring any further dividends and from increasing salaries for the time being. The regulators also discussed with the board the possibility of Manning merging with another financial institution or allowing the FHLBB or state authorities to take over should Manning become insolvent.

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In November, 1981, the FHLBB entered a temporary cease and desist order against Manning, requiring Manning to reduce expenses, refrain from paying dividends, and recapitalize. At that time, Manning's net worth was almost $500,000 below the required level. A forced merger or takeover by state or federal regulators was becoming a distinct possibility.

Faced with the imminent prospect of a forced merger or takeover, Ticktin embarked upon the first of several maneuvers to manipulate Manning's net worth and keep the FSLIC and FHLBB at bay. In November, 1981, Ticktin, on behalf of Manning Production Company, agreed to purchase interests in five Texas oil wells from Dalco Petroleum Company for $1,500,000. Manning Production, that same day, sold the interests to ITEX for $4,000,000. Manning and Manning Production supplied all the financing for ITEX's purchase. ITEX gave Manning a $1,000,000 full-recourse note. ITEX also gave Manning Production a $3,000,000 note. The $3,000,000 note was a non-recourse note, so if the oil wells did not produce, ITEX would not have to pay Manning Production on the note. But the non-recourse language did not appear on the note's face, as is standard; instead, a separate side agreement provided that the note would be non-recourse.

Ticktin wanted to record a profit immediately from the Dalco/ITEX transaction so he could increase Manning's net worth immediately. Ticktin requested opinions from four certified public accountants regarding whether he could record a profit ***1270** from the transaction; he wanted the answer in a hurry. The first two accountants told Ticktin that Manning could not record any profit from the transaction. The other two told Ticktin that Manning could record a profit. Ticktin accordingly recorded a $2,164,000 profit from the Dalco/ITEX deal, and reported that profit to the FHLBB. Ticktin, however, had not informed any of the accountants about the non-recourse side agreement; the belief that ITEX would be ultimately liable on the $3,000,000 note to Manning Production was a material factor in the opinions of the two accountants who advised Ticktin that he could record a profit.

James Scanlon was one of the accountants who approved the profit entry. Ticktin subsequently hired Scanlon's firm to conduct Manning's annual spring audit in 1982. While doing the audit, Scanlon attempted to certify that Manning had provided him with all documents concerning the Dalco/ITEX transaction. Ticktin assured Scanlon that Manning had provided the documents. However, Ticktin later misrepresented to Scanlon that Manning had released ITEX from personal liability on the $3,000,000 note in April, 1982.

Soon after the Dalco/ITEX transaction, Manning's net worth began to decline again. In March, 1982, the FHLBB challenged the Dalco/ITEX profit and drafted a proposed merger resolution for Manning. Sensing that Manning's net worth needed another boost, Ticktin returned to the oil business. In May, 1982, Ticktin instructed David Leibson, Manning's in-house counsel, to form a new corporation to buy oil and gas leases from Manning. Paul D. Olson was to be the corporation's sole shareholder. Manning and Olson were well-acquainted, and had a number of common economic interests. The corporation was named PDO Corporation (PDO).

On May 27, Ticktin, on behalf of Manning Production, purchased interests in three oil well leases from ITEX for $2,250,000. That same day, Manning Production sold the leases for $4,500,000 to PDO. PDO was eight days old at the time and had assets of $1,000, the amount of capital Olson paid in to start the corporation. To pay for the leases, PDO gave Manning Production a non-recourse note for $4,500,000. Ticktin recorded a $2,214,000 "profit" on the PDO transaction.

On July 14, 1982, an Administrative Law Judge found that Manning had improperly recorded a profit on the Dalco/ITEX transaction. The ALJ also found that Manning's net worth as of April 30, 1982 was negative $681,431. The ALJ entered a recommended order requiring Manning to meet its net worth requirements within twenty days or merge with another institution. The FHLBB adopted this order in October, 1982.

Against this background, Ticktin decided to take Manning into condominium financing. Jim Elliott and Kevin Kehoe, real estate brokers, were selling condominiums in a development in Orland Park, Illinois. First Security Bank of Glendale Heights, a bank in which Elliott had an interest, had been supplying the financing. After First Security ran

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out of money to finance the condominiums, Elliott turned to Ticktin. In late July, 1982 (shortly after the ALJ issued his recommended order), Ticktin agreed to have Manning finance 72 condominiums in Orland Park.

Kay Dwyer, Manning's vice-president, processed the loans. Manning's practice in the past had always been to verify borrowers' employment, deposits, and credit before making loans. Ticktin told Dwyer that she would not have to verify those items before making the Orland Park loans. Ticktin did tell Dwyer to obtain appraisals. Ticktin, however, told her what appraiser to use. The appraisals all came in together within two weeks and were merely photocopies, with only unit numbers changed. All two-bedroom units were appraised at the same price, regardless of location, as were all one-bedroom units.

Elliott and Kehoe sold the units at an inflated purchase price. Manning financed over 100 percent of the condominiums' true market value, and all but ten percent of the purchase price. The seller took second mortgages for the remainder of that price. Elliott and Kehoe received a commission of ***1271** $15,000 on each condominium they sold. Elliott's commissions totalled $1,000,000 and Kehoe's $172,000. Ticktin knew about these commissions.

In September, 1982, the FHLBB was on the verge of closing Manning down. Ticktin told Elliott that he had to "book a profit to keep the regulators at bay." Ticktin felt that buying and selling condominiums would again be a good way to do this. On October 28, on behalf of Manning Service Corporation, he purchased 123 condominiums and nineteen mortgages in Forest Park, Illinois for $3,400,000. Ticktin simultaneously sold the condominiums, in blocks of multiple units, to ten purchasers that Elliott, Kehoe, and Lloyd Tuttle recruited. Ticktin agreed to pay Elliott a commission of $10,000 per unit.

Ticktin set the purchase price and the financing terms. Nine of the purchasers bought twelve condominiums for $804,000, and a tenth bought fifteen condominiums for $1,009,800. Manning financed 100 percent of the purchase price: Manning loaned 80 percent of the price to each purchaser, and each purchaser executed a second mortgage for the remaining 20 percent. Although Manning's loan files contained appraisals justifying the purchase price, those appraisals were rife with inaccuracies and misrepresentations. The condominiums were overpriced, and Manning actually lent more than 100 percent of the fair market value of each.

Ticktin engineered the Forest Park deal so he could book a profit, increase Manning's net worth, and stave off action by the FHLBB. He soon learned from his accountants that he could not record any profit unless he could show a 20 percent down payment from the purchasers. Ticktin therefore had to devise a plan to create the appearance of a down payment. Ticktin's first idea was to loan $1,649,160 (20 percent of the total price) to Olson, who would then return the money as a supposed down payment from the purchasers. This plan fell through when Olson refused to participate unless Ticktin paid him $50,000.

After Olson refused to participate, Ticktin told Elliott to find additional people to borrow money to use for the down payments. Elliott recruited his parents, and Tuttle recruited Robert Bailey and Robert Lang. All four executed documents borrowing $229,790 from Manning; at the same time, each received Manning's irrevocable commitment to buy back the loan at the borrower's option, and each signed a letter exercising that option.

The loans to Bailey, Lang, and Elliott's parents provided only $919,160 toward the appearance of a 20 percent down payment. Two sources provided the rest of the down payment. Manning "bought" (no money ever changed hands) second mortgage notes from Elliott on another set of condominiums in Worth, Illinois. Manning paid the face value of $363,020 for these notes, even though the first mortgages on the Worth condominiums were delinquent. Ticktin also coerced Elliott into returning $361,000 of his commission on the Forest Park condominiums. Ticktin told Elliott that unless Elliott rebated $361,000, the whole deal would be off because Manning needed that amount to record a profit.

On November 16, Manning wired $2,510,760 to Elliott's account at Sears Bank. That $2,510,760 represented the money from the notes to Bailey, Lang, and Elliott's parents, the money from the sale

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of the Worth second mortgages, and Elliott's total commission. That same day, Sears Bank wired $1,649,160 (20 percent of the total Forest Park purchase price) from Elliott's account to Manning. The money wired back from Sears Bank served as the down payment on the Forest Park transaction.

After completing the transaction, Ticktin asked an accountant whether he could record a profit. Ticktin wanted the answer "lickety-split." Because there appeared to be a sufficient down payment, the accountant told Ticktin that Manning could record a profit. Ticktin reported a $2,263,000 profit. Actually, no profit could be properly recorded because all the funds in the transaction originated from Manning.

All the time Ticktin was manipulating Manning's books, he was also drawing extraordinarily high salaries, bonuses, and ***1272** other compensation. In 1981, Ticktin's salary was $85,000. By May, 1982, his salary was $100,000--despite Manning's precarious financial position and the FHLBB's express concern that Manning hold down expenses. Ticktin's 1982 compensation included much more than his salary. On January 5, 1982, Manning's five-member Board of Directors--which included Ticktin, Ticktin's father, Ticktin's wife, and Ticktin's father-in-law--voted Ticktin a $30,000 bonus. Ticktin himself voted to grant this bonus. Only four months later, on May 3, 1982, the Manning board (with Ticktin this time abstaining) voted Ticktin a $70,000 bonus for "the fantastic job that President Ticktin has done maintaining the net worth of the Association in these perilous times...." The times were indeed perilous but there was no net worth; Manning was insolvent. On December 16, 1982, two months after the FHLBB adopted the ALJ's recommended order that Manning increase its net worth or merge, the board (again, with Ticktin abstaining) voted Ticktin a $100,000 bonus "for the exemplary work that he has done turning the Association around and for the profits he has generated through Manning Service Corporation." The bonus was paid to Ticktin on January 26, 1983; one week later, the FSLIC closed Manning down.

Besides the salary and bonuses, Ticktin received substantial other consideration from Manning in 1982. In April, 1982, Ticktin received an assumable loan of $228,000 for 95 percent of the purchase price for a condominium in Scottsdale, Arizona. To help cover his Arizona living expenses, Manning gave Ticktin a $1,500 per month Arizona living allowance. Manning also bought two automobiles for Ticktin; a $12,000 automobile for his use in Arizona, and a $47,000 automobile for his use in Illinois. Finally, Manning paid Ticktin a $30,000 consulting fee. All told, Ticktin's compensation in 1982 from Manning--which was insolvent all or most of that year--totalled at least $289,000.

From February, 1982 onward, Ticktin had the sole authority to approve loans from Manning. During that time, while Manning was sinking, Ticktin made a number of substantial questionable loans. Many of these loans benefited Ticktin and his associates (primarily Olson and Elliott). On July 20, 1982, Ticktin made a $260,000 unsecured loan (the first Kay Dwyer had ever seen Manning make) to Olson. Two days later, Olson loaned Ticktin $287,650 from Olson's bank, the First Suburban Bank of Maywood.

A second loan from Manning to Olson on September 7, 1982, arose from prior dealings between Ticktin, Olson, and William Powers. Ticktin, Olson, and Powers had borrowed approximately $1,700,000 from American National Bank (ANB) in Chicago to purchase the Elgin National Bank. Elgin National Bancorp, Elgin National Bank's holding company, also owed ANB $3,000,000. As of August, 1982, both the individuals' and the Bancorp's obligations to ANB were in default. On September 2, Olson agreed to assume Ticktin's individual loan and guarantee of Powers' loan. ANB agreed to continue the $3,000,000 Elgin Bancorp loan if Olson paid the individual loans within one week. Five days later, Ticktin loaned Olson $1,593,000 from Manning Service Corporation, secured by 108,023 shares of Elgin Bancorp stock. There were two problems with this collateral: Elgin Bancorp was in default on its $3,000,000 loan, and Elgin Bancorp's loan from ANB was secured by stock in Elgin National Bank. ANB had first priority on the Elgin National Bank stock. If Elgin Bancorp could not meet its obligations to ANB (and its track record was not very good), ANB could take the Elgin National Bank stock, which was Elgin Bancorp's underlying asset. Thus, the Elgin Bancorp stock was worth little, if anything, as collateral, and the loan from Manning to Olson was undercollateralized. After

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Olson received the money from Manning Service Corporation, he used it to extinguish the outstanding individual obligations to ANB.

Six days after the $1,593,000 loan to Olson, Ticktin loaned $300,000 to Tuttle and $300,000 to Kehoe from Manning Service Corporation. Ticktin told Ted Guillem, a Manning vice-president, to use $350,000 of the loan proceeds to pay off part of the ***1273** loan that Ticktin had made to Olson on September 7, and $150,000 to pay off part of a loan that Ticktin had made to Elliott. As part of this transaction, Olson gave Tuttle and Kehoe shares of Elgin National Bank stock; Tuttle and Kehoe pledged those shares as collateral for their loans. Inexplicably, though, Kehoe pledged twice as many shares as Tuttle for the same loan.

When Manning failed, the United States Attorney's office investigated the circumstances. That investigation resulted in a twenty-one count indictment naming Ticktin, Olson, Kehoe, Elliott, Lang, Bailey, and Michael Kelley, a purchaser in the Forest Park deal, as defendants. Elliott and Kelley pleaded guilty and testified for the government at the trial. Olson, who was tried along with the remaining defendants, was found guilty on six of seven charges. He has appealed, but his appeal is not part of this consolidated appeal. The jury found Ticktin, Kehoe, Bailey, and Lang guilty on all counts charged.

II.
Sufficiency of the Mailings in Counts Five, Six, and Seven

[1] The only counts in the indictment naming Kehoe were Counts Five, Six, and Seven. In those counts, the grand jury charged Ticktin, Elliott, and Kehoe with mail fraud in connection with the Orland Park condominium transaction. Each of those counts alleged the mailing of recorded mortgages from the Recorder of Deeds to Manning as the count mailing. In United States v. Kwiat, 817 F.2d 440 (7th Cir.1987), we held that similar mailings were insufficient to support Kehoe's conviction for mail fraud in connection with the part of the Orland Park condominium deal that First Security Bank of Glendale Heights financed. Kehoe contends that we must reverse his convictions here in light of Kwiat. The government has confessed error on Kehoe's convictions, and we agree with the parties that the mailings alleged in Counts Five, Six, and Seven are indistinguishable from those alleged in Kwiat. Therefore, we reverse Kehoe's conviction.

[2][3] Counts Five, Six, and Seven also charged Ticktin with mail fraud. Ticktin did not raise the sufficiency of the mailings in those counts in his opening brief. But it would be plain error to affirm Ticktin's conviction on those counts while holding that those counts fail against Kehoe. See Kwiat, 817 F.2d at 444; Fed.R.Crim.P. 52(b). Therefore, we also reverse Ticktin's convictions on Counts Five, Six, and Seven. [FN1]

> FN1. Reversing these three mail fraud convictions does not, as Ticktin argues, automatically require that we reverse his convictions on all the counts in the indictment. All of the indictment's counts were properly joined, Fed.R.Crim.P. 8(a), and there was no basis for a severance under Fed.R.Crim.P. 14. Also, all of the indictment's charges were similar in character and arose from the same overall scheme to loot Manning. Finally, most, if not all, of the evidence admitted on Counts Five, Six, and Seven would have been admitted even absent those counts. Therefore, our reversing Ticktin's convictions on Counts Five, Six, and Seven does not require us to reverse his convictions on the other counts. See generally United States v. Holzer, 840 F.2d 1343, 1349-50 (7th Cir.1988); United States v. Dicaro, 772 F.2d 1314, 1320-21 n. 4 (7th Cir.1985).

III.
Sufficiency of the Evidence to Convict Bailey and Lang

Bailey and Lang were each charged with and convicted of one count of mail fraud. They contend that there was insufficient evidence to prove that they intended to defraud the FSLIC, FHLBB, or Manning's depositors and shareholders. We agree.

[4] To convict Bailey and Lang, the government could not simply show that they participated in a transaction that turned out to be part of a fraudulent scheme. The government also had to show Bailey's and Lang's "willful participation in [the] scheme with knowledge of its fraudulent nature and with intent that these illicit objectives be achieved." United States v. Price, 623 F.2d 587, 591 (9th Cir.1980); see also United States v. Pearlstein, 576 F.2d 531, 537 (3d Cir.1978); United States v.

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***1274** Stull, 743 F.2d 439, 442 (6th Cir.1984). "[T]he requisite mental state in a prosecution for fraud is a specific intent to defraud and not merely knowledge of shadowy dealings." United States v. Piepgrass, 425 F.2d 194, 199 (9th Cir.1970).

[5] Tuttle recruited Bailey and Lang to borrow money to serve as a down payment for the Forest Park purchasers. Elliott and Tuttle met one day with Bailey at a restaurant and explained the transaction to him. Elliott would pay Bailey $5,000 in exchange for using Bailey's name and being able to make the loan. Bailey looked "a little bit funny" and "raised his eyebrows." He asked Elliott if the transaction was legitimate; Elliott responded that it was, explaining that his parents were entering into the same deal, and that a savings and loan president (Ticktin) would be standing behind the non-recourse aspect of the note. After also receiving assurances from Tuttle that the transaction was legitimate, Bailey agreed to participate.

Tuttle later contacted Lang and told him about the transaction. Tuttle explained the transaction to Lang as Elliott had explained it to Bailey, and assured Lang that it was legitimate. Lang also agreed to participate.

A few weeks passed. On November 17, 1982, Bailey and Lang received phone calls telling them to come to Elliott's office and sign the loan papers for the Forest Park deal. Bailey and Lang both signed documents borrowing $229,790 from Manning. The loans were secured by second mortgages from the Forest Park purchasers. Bailey and Lang also received letters from Ticktin on Manning stationery. The letters allowed Bailey and Lang to discharge their loans by tendering the collateral back to Manning within thirty days of the loan's maturity date; Manning was irrevocably committed to take back the collateral and discharge the debt. At the same time, Bailey and Lang signed letters exercising their options to tender the collateral back to Manning. Thus, Bailey and Lang got into and out of the transaction on the same day, and made $5,000 for their efforts.

The government offered no direct evidence that Bailey and Lang intended to defraud the FSLIC, FHLBB, or Manning's depositors and shareholders. The only direct evidence concerning Bailey's and Lang's participation was Elliott's and Tuttle's testimony--and both Elliott and Tuttle testified that they had assured Bailey and Lang that the transaction was legitimate.

Direct evidence, however, is not necessary to prove knowledge and intent to defraud. The government contends that the circumstances surrounding the loan transaction allowed the jury to properly infer Bailey's and Lang's guilty knowledge and intent. Alternatively, the government argues that the jury could properly infer that Bailey and Lang suspected that the transaction might be defrauding Manning but deliberately avoided further knowledge for fear of what they might learn. This combination of suspicion and deliberately avoiding further knowledge may support an inference of actual knowledge or criminal recklessness sufficient to convict. See United States v. Ramsey, 785 F.2d 184, 189 (7th Cir.1986). The district court gave an "ostrich" instruction, informing the jury that it could "infer knowledge from a combination of suspicion and indifference to the truth." See id. at 190.

The government characterizes its circumstantial case against Bailey and Lang as "powerful"; we characterize it as insufficient. The scheme was one to deceive the FSLIC, FHLBB, and Manning's depositors and shareholders. As we will discuss in more detail later, the government's theory was that Ticktin fraudulently inflated Manning's net worth to keep the federal regulators at bay so he could keep Manning open and plunder it. Nothing suggests that Bailey and Lang knew or had reason to know about Manning's precarious financial position, the FHLBB's scrutiny, or Ticktin's efforts to manipulate Manning's books. There is no evidence that Bailey or Lang had any expertise in banking or real estate financing. Cf. Pearlstein, 576 F.2d at 543-44. The government notes that both Bailey and Lang were small businessmen who were involved in local politics. ***1275** But to infer any special knowledge from this requires too great a leap; the government offered very little detail about Bailey's and Lang's business and political experience, and not all small businessmen and politicians are familiar enough with real estate financing to suspect an illegal or fraudulent transaction. Bailey and Lang may have suspected (or even known) that the loan transactions they were entering were not "standard operating procedure." But Elliott and Tuttle, both highly regarded and respected real estate brokers at

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the time, assured Bailey and Lang that the deal was legitimate. Compare United States v. Browne, 225 F.2d 751, 758 (7th Cir.1955). The evidence reveals no reason why Bailey and Lang should have doubted Elliott and Tuttle. Bailey and Lang had been involved in other deals with Elliott and Tuttle (including Orland Park); the government does not suggest that Bailey or Lang had reason to doubt that those transactions were legitimate. Elliott even told Bailey that Elliott's parents were involved in the same transaction. Bailey and Lang also had Ticktin's assurance, implied through his participation, that the transaction was legitimate. There was no evidence that Bailey or Lang knew Ticktin personally. They knew only that he was President of Manning Savings and Loan. Ticktin's participation would tend to signal that the transaction was not one meant to harm Manning.

The "ostrich" instruction does not save this conviction. "[I]t takes a fairly large amount of knowledge" to permit a jury to infer guilty knowledge under an "ostrich" theory; "to permit an inference of knowledge from just a little suspicion is to relieve the prosecution of its burden of showing every element of the case beyond a reasonable doubt." Ramsey, 785 F.2d at 190. There was no evidence--except, perhaps, Bailey's "raised eyebrows" and "funny" look--that Bailey or Lang harbored any suspicion that would have required them to investigate Manning or Ticktin's relationship and dealings with Manning or that Bailey or Lang deliberately avoided seeking further knowledge for fear of what they might learn. In fact, as we have noted, Bailey did ask, and he was assured by two people with much greater expertise and experience than he that the deal was legitimate. Speculation, "funny" looks, and "raised eyebrows" are not sufficient to convict people for knowingly participating in a scheme to defraud. Therefore, we reverse Bailey's and Lang's convictions.

IV.
The Validity of Ticktin's Mail Fraud Convictions in Light of McNally v. United States

[6] In McNally v. United States, --- U.S. ----, 107 S.Ct. 2875, 97 L.Ed.2d 292 (1987), the Supreme Court rejected the so-called "intangible rights" theory of mail fraud, holding that the mail fraud statute makes criminal only schemes intended to deprive people of property rights. See id. 107 S.Ct. at 2879-80; see also Carpenter v. United States, --- U.S. ----, 108 S.Ct. 316, 320, 98 L.Ed.2d 275 (1987). Ticktin asserts that we must reverse his mail fraud convictions in light of McNally. [FN2]

> FN2. Bailey, Lang, and Kehoe also challenged their convictions as invalid under McNally. Because we have reversed their convictions for other reasons, see supra at 1274-77, we consider only Ticktin's McNally challenge.

Ticktin contends that the indictment's mail fraud counts do not state an offense under McNally. At first blush, Ticktin appears to be right. The specific charging language in each of the mail fraud counts alleges that Ticktin schemed to defraud Manning's depositors and shareholders, the FSLIC, and the FHLBB "out of their right to have the affairs of the Manning Savings and Loan Association conducted honestly, fairly, and free from craft, trickery, deceit, corruption, dishonesty and fraud." Standing alone, this language does not pass muster under McNally; the right to honest services is "too ethereal in itself to fall within the protection of the mail fraud statute...." Carpenter, 108 S.Ct. at 320.

Even though each specific charge is couched in "intangible rights" language, the substantive allegations in each mail ***1276** fraud count charge a "scheme that had substantial potential to take other people's property by fraud," and therefore state offenses under McNally. United States v. Keane, 852 F.2d 199, 205 (7th Cir.1988). As we noted in United States v. Wellman, 830 F.2d 1453, 1462 (7th Cir.1987), the common thread running through "intangible rights" cases is that they involve rights whose violation would ordinarily result in no concrete economic harm; that is not the case here. All eleven mail fraud counts charged that Manning was in a precarious financial position, and that Ticktin artificially inflated Manning's net worth. The counts also charged that Manning was an insured institution, with the FSLIC insuring each depositor's account up to $100,000. The counts also state that Ticktin's family members controlled the Board of Directors and had the authority to grant Ticktin salary, loans, and bonuses. Each count thus alleged schemes with the potential to expose Manning's money and property to plunder by artificially keeping Manning in operation. This could affect the property interests of the depositors,

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shareholders, and FSLIC, which would be potentially on the hook for some or all of the depositors' losses.

The mail fraud counts also alleged other affected property interests. The Forest Park counts alleged that Ticktin loaned more than $6,500,000 with no down payments to the Forest Park purchasers, and $916,160 to Bailey, Lang, and Elliott's parents to create the appearance of a down payment. These counts also alleged that Ticktin paid commissions to Elliott as part of the deal. These counts thus alleged that Ticktin defrauded Manning's shareholders and depositors out of their property interests by committing Manning's funds to the loans, depriving Manning of down payments it would have otherwise received, and paying Manning's funds to Elliott for commissions.

The Dalco/ITEX count alleged that Ticktin paid $1,500,000 for the oil and gas leases, and financed the resale that same day for $4,000,000. Of that $4,000,000, $3,000,000 was both undersecured and without recourse, thus putting Manning's funds at greater than usual risk. The PDO counts alleged that Manning purchased leases from ITEX for $2,250,000, sold them to PDO for $4,500,000, and financed PDO's purchases. The PDO counts also alleged that on May 3, 1982, the directors voted a $70,000 bonus to Ticktin.

[7] Thus, although the government would no doubt draft the indictment differently today, the indictment sufficiently alleged mail fraud offenses even after McNally. But the indictment also alleged "intangible rights" mail fraud. We must examine the jury instructions, along with the evidence and arguments at trial to see if the jury necessarily convicted Ticktin of conduct that constituted an offense. See Wellman, 830 F.2d at 1462-63.

[8] The trial judge properly instructed the jury that to convict Ticktin it had to find beyond a reasonable doubt:

> 1) that the defendant knowingly participated in a scheme to defraud, as described in the indictment;
> 2) that, for the purpose of carrying out a scheme or attempting to do so, the defendant used the United States mails or caused the United States mails to be used in a manner charged in the particular count;
> 3) that the defendant did so knowingly and with the intent to defraud.

The instructions also defined a "scheme" and "intent to defraud":

> A "scheme" means some plan or course of action intended to deceive another and to deprive another of something of value by means of false pretenses, representations, or promises.
> It is not necessary that the government prove all of the false pretenses, representations, promises, and acts charged in the indictment. However, it is essential that the evidence establish beyond a reasonable doubt that the defendants intended to deceive the shareholders, depositors, or the FSLIC to their detriment.
> ....
> To act with intent to defraud means to act willfully and with the specific intent ***1277** to deceive or cheat; ordinarily for the purpose of either causing some financial loss to another, or bringing about some financial gain to oneself or another.

The judge further instructed the jury that:

> It is a theory of Harold J. Ticktin's defense in this case that he undertook all of his activities with respect to the ITEX, PDO, Orland Park, and Forest Park transactions in good faith for the purpose of benefiting rather than injuring the financial position of Manning Savings and Loan Association, and not for the purpose of his own improper financial gain. Since it is an element of all the crimes charged that Defendant Harold J. Ticktin had the intent to injure or defraud the association, you should acquit him if you find the government has not proved beyond a reasonable doubt that Defendant Ticktin had the requisite intent.

Ticktin argues that the court's instructions did not sufficiently ensure that the jury convicted him only for schemes that injured (or could have injured) the victims' property rights. When examining the sufficiency of jury instructions we must examine the jury charge as a whole, rather than focus on isolated passages. Moreover, because " 'a judgment of conviction is commonly the culmination of a trial which includes testimony of witnesses, argument of counsel, receipt of exhibits in evidence, and instruction of the jury by the judge,' " we review the instructions in the context of the overall trial and the arguments by counsel. See United States v. Piccolo, 835 F.2d 517, 519 (3d Cir.1987) (quoting Cupp v. Naughten, 414 U.S. 141, 147, 94 S.Ct.

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396, 38 L.Ed.2d 368 (1973)).

Ticktin asserts that the definition of "scheme" does not limit "something of value" to money or property. In Wellman, we found the same language to be consistent with McNally. See 830 F.2d at 1463. Unlike United States v. Holzer, 840 F.2d 1343, 1346 (7th Cir.1988), nothing in the instructions specifically advised the jury that "intangible rights" could be "something of value" for purposes of finding a scheme.

The jury instruction defining "intent to defraud" equated that intent with an intent to cause financial loss to another or bring about financial gain to oneself. Ticktin complains that the word "ordinarily" made the instruction open-ended, and allowed the jury to find intent even absent an intent to bring about financial gain or loss. We think, however, that Ticktin parses this instruction much more closely than the average juror would; read naturally, the instruction defining intent focuses on financial gain or loss. Furthermore, Ticktin's "good faith" theory of defense instruction (which Ticktin has understandably ignored on appeal) clearly equates intent to defraud with an intent to injure Manning and bring about improper financial gain for Ticktin. Taken together, the intent instruction and Ticktin's good faith instruction adequately informed the jury that it had to find conduct aimed at injuring Manning's financial interests to convict Ticktin of mail fraud. A scheme to injure Manning financially is necessarily one to injure its shareholders and depositers financially.

Finally, the evidence and arguments in this case emphasized that the schemes were aimed at Manning's property. This case is unlike Holzer and Ward v. United States, 845 F.2d 1459 (7th Cir.1988), where the government's attorneys argued at trial that the jury should convict the defendants for depriving their victims of honest services but then adopted a different argument on appeal. From the beginning of the trial, the government's theory has been that Ticktin had "looted" Manning through a series of mail fraud schemes and misapplications. The jury heard testimony about how Ticktin's schemes depleted Manning's assets. And the closing arguments are replete with references to Ticktin using the transactions in the mail fraud schemes to artificially keep Manning open so he could divert more of its assets into his own pocket. Manning was, as the government puts it, "the goose that laid the golden eggs" and Ticktin had to keep that goose alive ***1278** while there were still eggs to be gathered. [FN3]

> FN3. Ticktin argues that the jury instruction defining a "scheme" allowed the jury to convict Ticktin solely for conduct "intended to deceive ... the FSLIC." But the trial evidence and arguments made clear that deceiving the FSLIC was an integral part of defrauding Manning's shareholders and depositers of their property; the FSLIC and FHLBB had the power to shut Manning down and thus deny Ticktin access to Manning's funds. Moreover, as the indictment alleged, the FSLIC had a property interest at stake: the $100,000 per depositer it might have had to pay had Manning gone under. Thus, the reference to scheming to deceive the FSLIC does not require us to reverse Manning's conviction.

[9] In sum, the indictment adequately alleged conduct that violated the mail fraud statute, and the trial evidence and arguments, along with the jury instructions, convince us that the jury necessarily found that Ticktin's schemes were aimed at his victims' property rights. Therefore, Ticktin's mail fraud convictions (except, as we have already noted, the Orland Park convictions) were proper. [FN4]

> FN4. Since the RICO count alleged the substantive mail fraud counts as predicate offenses and we have upheld Ticktin's other mail fraud convictions, we also uphold his RICO conviction even though we have reversed Counts Five, Six, and Seven. The jury has "no discretion to pick and choose among predicate offenses." Holzer, 840 F.2d at 1351.

V.
Ticktin's Convictions for Misapplying Manning's Funds

Ticktin challenges the sufficiency of the evidence to convict him for misapplying Manning's funds and the district court's refusal to give certain jury instructions on misapplication that he tendered. The savings and loan misapplication statute, 18 U.S.C. § 657 states, in relevant part:

> Whoever, being an officer ... of ... any ... savings and loan association ... the accounts of which are insured by the Federal Savings and Loan Insurance Corporation ... willfully

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misapplies any moneys, funds, credits, securities, or other things of value belonging to such institution or pledged or otherwise entrusted to its care, shall be fined not more than $5,000 or imprisoned not more than five years, or both....

The district court instructed the jury that:

To sustain a charge of willful misapplication by Ticktin ... the government must prove the following propositions:

First, that at the time of the offense charged, the defendant was an officer, an agent, an employee of or connected in any capacity with Manning Savings and Loan Association;

Second, that the Manning Savings and Loan Association was an insured association;

Third, that the defendant used his position as an officer and agent to willfully misapply moneys, funds and credits belonging to the association, or entrusted to its care;

Fourth, that the defendant did so willfully and with the intent to injure or defraud the association.

....

A "willful misapplication" ... is an unauthorized, unjustifiable, or wrongful use of the association's funds with the intent to injure or defraud the association.

To show a willful misapplication, the government must prove a conversion of [the] association's funds to the use of a defendant or third party. However, ... actual loss need not be proved. It is sufficient that the defendant at least temporarily deprived the association of the possession, control or use of its funds.

The word "willfully" means that the person knowingly and intentionally committed the acts which constitute the offense charged.

The district court's instructions accurately stated the elements of a § 657 violation. See United States v. Marquardt, 786 F.2d 771, 785 (7th Cir.1986). The district court also accurately defined the term "willful misapplication." See United States v. Olson, 825 F.2d 121, 122-23 (7th Cir.1987). But Ticktin argues that the instructions were incomplete and did not adequately ***1279** distinguish between criminal misapplication and mere maladministration. Ticktin appeals the district court's decision to refuse to give several of his tendered instructions that he claims would have cured this alleged defect.

A. The Bonus Counts.

[10] The jury convicted Ticktin on Counts 14, 15, and 20, for accepting bonuses from Manning. Since the Board of Directors voted him the bonuses, Ticktin tendered an instruction stating that the board's consent was a complete defense to the misapplication charges. Ticktin based this instruction onUnited States v. Britton, 108 U.S. 193, 2 S.Ct. 526, 27 L.Ed. 701 (1883) (Britton III). In Britton III, the indictment charged that Britton, who was president of the National Bank of the State of Missouri, had made a promissory note to his brother, who endorsed it back to Britton. Britton submitted the note to the bank's Board of Directors who discounted the note, and Britton took the proceeds for his own use. At the time, Britton knew that both he and his brother were insolvent. The Supreme Court held that the Board of Directors, "knowing all the facts," could discount the note, and that the indictment did not charge an offense against Britton. Id. at 197, 2 S.Ct. at 529.

Britton III does not stand for the broad principle that consent by the Board of Directors is an absolute defense to misapplication. Britton III turned on a technical defect in the pleadings: the indictment did not charge that Britton had fraudulently procured the discount. See id. In any event, the Court's subsequent decision in Evans v. United States, 153 U.S. 584, 14 S.Ct. 934, 38 L.Ed. 830 (1893) undercut the broad reading of Britton III that Ticktin proposes. In Evans, a bank director was charged with (among other things) aiding and abetting the bank's cashier's misapplication by presenting a note to the cashier to discount; both knew that the note was not adequately secured. Id. at 591-92, 14 S.Ct. at 937-38. One of Evans' arguments for dismissing the charge was that the indictment did not charge that the cashier was not authorized to discount the note. Id. at 592-93, 14 S.Ct. at 938. The Court held even if the board had authorized the cashier to discount the note, if he discounted it with the intent to defraud the bank he would be guilty of criminal misapplication. Id. at 593, 14 S.Ct. at 938. Thus, under Evans, the Board of Directors' consent is not an absolute defense to a misapplication charge.

[11] As more recent cases have held, the board's consent is an important factor to consider in determining whether a defendant attempted to defraud an institution. But if intent to defraud or injure exists, the Board of Directors' approval is irrelevant. See United States v. Cauble, 706 F.2d

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1322, 1353-54 (5th Cir.1983); United States v. Beran, 546 F.2d 1316, 1321 (8th Cir.1976).

[12] Ticktin submitted a second instruction that the district court refused to give concerning the bonuses. This instruction would have told the jury that Ticktin's "acting in his official capacity in accepting the salary and bonuses" was a complete defense. Ticktin based this instruction on another in the line of Britton cases, United States v. Britton, 108 U.S. 199, 2 S.Ct. 531, 27 L.Ed. 698 (1883) (Britton IV). In Britton IV, Britton was charged with misapplying the bank's funds by conspiring with another director to persuade the bank's directors to declare a dividend even though he knew that the bank had no net profits with which to pay it. Id. at 206, 2 S.Ct. at 535. The Court held that "[t]he declaring of a dividend by the association when there were no net profits to pay it ... is an act done by an officer of the association in his official and not in his individual capacity" and was therefore not a misapplication. Read broadly, Britton IV seems to hold that any act performed by an officer in his official capacity is not a misapplication.

However, Evans undercuts this broad reading of Britton IV, just as it undercuts the broad reading of Britton III. Evans held that a bank officer or employee who fraudulently discounts a worthless note commits a criminal misapplication, even ***1280** though discounting notes is part of his job (i.e., his "official capacity"). Evans, 153 U.S. at 593, 14 S.Ct. at 938. Similarly, as the Third Circuit stated almost forty years ago in construing Britton and Evans, "[i]f a dividend be illegally declared with the intent to defraud the bank the persons responsible for the declaration face criminal sanctions and have committed the crime defined by the statute." United States v. Matsinger, 191 F.2d 1014, 1017 (3d Cir.1951). Intent is the key element: "[T]he gravamen of the offense consists in the evil design with which the misapplication is made...." Evans, 153 U.S. at 594, 14 S.Ct. at 938.

[13] Neither of Ticktin's proposed instructions concerning the bonuses accurately stated the law. The district court did not err in refusing to give these instructions. In any event, the district court did instruct the jury on both board approval and official capacity as theories of Ticktin's defense. Ticktin was able to argue both these points to the jury. He was entitled to no more.

[14] The evidence was sufficient to convict Ticktin on all the misapplication counts concerning the bonuses. There was ample evidence for the jury to believe the government's theory that Ticktin embarked on a series of fraudulent schemes to keep Manning artificially alive and to believe that Ticktin was able to receive the bonuses because of his pattern of fraudulent conduct. This pattern supported an inference that Ticktin intended to defraud Manning when he accepted the bonuses. Moreover, each bonus was awarded to Ticktin at a time when he knew Manning had a negative net worth. The board was dominated by Ticktin's family, and Ticktin himself voted to grant the initial bonus. The board awarded the final two bonuses based on Ticktin's "fantastic" and "exemplary" work in turning Manning around and maintaining its profits, raising an inference that Ticktin deceived the board about Manning's true financial condition. In short, there was sufficient evidence for the jury to find that by accepting the bonuses Ticktin converted Manning's funds to himself with the intent to defraud or injure Manning.

B. The Loan Counts.

The jury convicted Ticktin on the other misapplication counts for five loans he made: a $260,000 loan to Olson, a $1,500,000 loan to Olson, $300,000 loans to Tuttle and Kehoe, and a $634,200 loan to Michael Kelley as part of the Forest Park transaction. The indictment alleged that the loans to Olson, Elliott, and Kehoe were unsecured or insufficiently secured. The indictment also alleged that Ticktin made the $1,500,000 loan to Olson for Ticktin's own benefit, and that Ticktin paid the proceeds of the loans to Tuttle and Kehoe over to Olson, and not the named borrowers. The indictment alleged that the loan to Kelley was secured by overvalued property, and that Kelley had not supplied a down payment for the loan.

[15][16] Ticktin submitted an instruction stating that it is not a misapplication for a bank officer to make a loan with little or no collateral. It is true that lack of collateral, by itself, does not make a loan a misapplication. Banks often make unsecured loans, based on the borrower's wealth, general creditworthiness, and other risk factors; increased interest compensates the lender for the increased risk involved. It would be an incredible and unjustified expansion of the misapplication statute to put

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bankers in jail simply for making unsecured loans.

But Ticktin's proposed instruction is incomplete and misleading. An unsecured or undersecured loan can be a misapplication, if made with the intent to defraud or injure the bank. United States v. Kahn, 381 F.2d 824, 832 (7th Cir.1967); cf. Evans, 153 U.S. at 592, 14 S.Ct. at 938 (discount of unsecured note is misapplication if made with intent to defraud). Ticktin's instruction would have focused the jury's attention solely on the lack of collateral and away from other facts from which the jury could have inferred an intent to defraud or injure Manning. Because Ticktin's proposed instruction did not accurately state ***1281** the law, the district court did not err in refusing to give it.

[17] Ticktin also submitted an instruction that would have informed the jury that it is not a misapplication for a bank officer to make a loan knowing that the named borrower will turn the proceeds over to a third party, unless the officer knows that the named borrower will not or cannot repay the loan. Ticktin based this instruction on United States v. Gens, 493 F.2d 216, 222 (1st Cir.1974) and United States v. Gallagher, 576 F.2d 1028, 1045-46 (3d Cir.1978). Those cases held that, "absent other circumstances," Gens, 493 F.2d at 222, it was not a criminal misapplication for a bank officer to loan money to one person knowing that the named borrower will pass the proceeds to other persons, except in three situations: where the bank officer knows the named borrower is either fictitious or unaware that his name is being used; where the bank officer knows that the named debtor will be unable to repay the loan; and where the bank officer assures the named borrower that he will not have to repay the loan. Gens, 493 F.2d at 221-22; Gallagher, 576 F.2d at 1046. This circuit has cited Gens and Gallagher in holding that merely loaning money to a named borrower for somebody else's benefit is not, absent more, a criminal misapplication. United States v. Bruun, 809 F.2d 397, 411-12 (7th Cir.1987); see also United States v. Olson, 825 F.2d at 123 (dictum); United States v. Shivley, 715 F.2d 260, 265 (7th Cir.1983) (dictum).

[18] But Ticktin's proposed instruction concerning third-party loans was also incomplete and misleading. The instruction ignores the principle, clearly and repeatedly stated in this circuit, that when a bank officer makes a loan to a third party for the officer's own ultimate benefit he has made a criminal misapplication, regardless of the named borrower's intent or ability to repay the loan. See, e.g., Olson, 825 F.2d at 123; Bruun, 809 F.2d at 412; Shivley, 715 F.2d at 265. Ticktin claims that a third-party loan can never be a misapplication if the named borrower can and will repay it, but this circuit has never held that. See, e.g., Olson, 825 F.2d at 123 ("Without more," such third-party loans to financially capable borrowers are not misapplications). (Emphasis added.) And Gens and Gallagher did not set out an exhaustive list of situations in which third-party loans could or could not be misapplications; Gens itself acknowledged that other circumstances could make such loans criminal misapplications. 493 F.2d at 222; see also United States v. Kennedy, 564 F.2d 1329, 1339 (9th Cir.1977). If all the facts and circumstances surrounding a particular loan indicate that a bank officer intended to defraud or injure the bank, then the jury may properly find that the loan was a criminal misapplication despite the named borrower's willingness and ability to repay it. The intent to defraud or injure the bank is what separates criminal misapplication from mere maladministration.

[19] The evidence was sufficient to convict Ticktin for misapplication on all five loan counts. The first loan count involved a $260,000 loan to Olson. That loan was unsecured. The loan shortly followed the PDO transaction, and could be seen as a payoff for Olson's participation in that scheme. And two days later Olson loaned Ticktin $287,650 from Olson's First Suburban Bank of Maywood, secured by Manning shares (ten days after the ALJ had ordered Manning to increase its net worth or close down). It was a reasonable inference that the loan to Ticktin was in exchange for the loan to Olson. This inference is buttressed by the overall relationship between Ticktin and Olson, and by evidence of the fact that that relationship proceeded on an essentially quid pro quo basis--for example, Olson's demand that Ticktin pay him $50,000 to participate in the Forest Park scheme. Thus, the loan to Olson benefited Ticktin; it was a clever way for Ticktin to circumvent the regulations prohibiting him from loaning himself money from Manning.

The $1,500,000 loan to Olson was secured by Elgin Bancorp stock, stock that was worth little, if

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anything, as collateral. Olson used a substantial part of this loan to ***1282** pay off Ticktin's personal obligation at American National Bank. Although Olson had agreed to assume this obligation five days before receiving the loan, Ticktin had agreed to loan him the money before Olson assumed the obligation. The loan could thus be seen as one that benefited Ticktin by allowing himself to pay off a personal obligation with Manning's money.

The $300,000 loans to Kehoe and Tuttle arose out of the $1,500,000 loan to Olson. All or part of each loan went to pay part of the $1,500,000 loan that Olson had used, in part, to pay off Ticktin's obligation at ANB. Thus, these loans could be seen as part of a "complicated morass of clandestine financial dealings ... [that] ultimately inured" to Ticktin's benefit. Olson, 825 F.2d at 123. These loans were also secured by Elgin Bancorp stock, so these loans were also undersecured.

The indictment's final misapplication count charged that Ticktin misapplied Manning's funds by loaning $643,200 to Michael Kelley, one of the purchasers in the Forest Park deal. Kelley never met with a loan officer, and was paid $6,000 to participate in the transaction. Kelley also made no down payment on the condominiums he purchased. That in itself may not indicate any intent to defraud because it is not uncommon for bankers to loan 100 percent of the purchase price of a piece of real estate, based on the borrower's creditworthiness and other risk factors. Here, however, there was evidence that Ticktin never evaluated any of these factors before making the loan to Kelley. Moreover, Ticktin went out of his way to create the appearance of a 20 percent down payment for the Kelley loan and the other Forest Park loans, even though Manning never actually received any down payments. There was also evidence that the condominiums Kelley purchased were valued well above their market price, and that Manning financed more than the market price for the purchase.

[20] We finally note that the government tried and argued the misapplications as part of its overall theory that Ticktin concocted several fraudulent schemes designed to bilk Manning of a substantial amount of its assets. We cannot view each misapplication count in isolation; instead, we must view the counts in light of Ticktin's overall course of conduct and in light of the fact that by convicting Ticktin on every count charged, the jury obviously believed the government's theory. Given this, it is difficult to believe that the jury would have convicted Ticktin on the misapplication counts unless it found that he intended to enrich himself at Manning's expense. Ticktin's convictions on the misapplication counts were proper. [FN5]

FN5. On both the loan and bonus counts, Ticktin rather obliquely seems to argue that the indictment did not state offenses. His opening brief mentions the allegations in the indictment but focuses its argument on the sufficiency of the evidence and the jury instructions. His reply brief is more forthright in arguing that the indictment did not state offenses but it does not discuss the applicable standards for determining an indictment's sufficiency. Assuming Ticktin has properly presented the issue, we hold that the misapplication counts sufficiently stated offenses. Each count alleged that Ticktin was an officer of Manning, that Manning was federally insured, that Ticktin willfully misapplied Manning's funds and how he misapplied those funds, and that Ticktin acted with the intent to injure or defraud Manning. See United States v. Broome, 628 F.2d 403, 405 (5th Cir.1980) (per curiam). Ticktin also argues that reversing any substantive misapplication count requires us to reverse the conspiracy counts as well. Because we affirm the substantive misapplication counts, we do not reach this argument.

VI.
Alleged Erroneous Evidentiary Ruling

Ticktin finally contends that we must reverse his conviction on all counts because an evidentiary ruling by the district court deprived him of a fair trial. While questioning David Liebson, Manning's in-house attorney, the government's attorney asked Liebson how Ticktin billed the legal services that Liebson performed for Olson at Ticktin's request. Liebson answered that Ticktin billed those services under the letterhead of Ticktin's private law firm. Ticktin's counsel immediately objected, but the ***1283** district court refused to strike Liebson's answer.

On appeal, Ticktin argues that the district court abused its discretion by not striking Liebson's answer and allowing the government to ask further questions about the billing arrangement (eliciting the

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same information). According to Ticktin, Liebson's testimony was "other acts" evidence under Fed.R.Evid. 404(b) that the district court should not have admitted because the government failed to disclose the evidence before trial. Ticktin also asserts that the evidence was irrelevant to any issue in the case, and unduly prejudicial to him.

[21][22] Rule 404(b) prohibits evidence of other acts "to prove the character of a person in order to show action conforming therewith." Assuming that Liebson's testimony about the billing was Rule 404(b) evidence, its admission was not reversible error. For one thing, the evidence was admissible. The testimony was relevant to the conspiracy count and other counts involving Ticktin and Olson because it showed the nature of the relationship between them. Any potential for unfair prejudice to Ticktin was minimal at best. Liebson's response was an isolated piece of testimony from a trial that lasted almost four weeks, and the government never argued or presented evidence to show that the billing arrangement was improper. And even if the admission of the evidence violated the district court's prior disclosure order, Ticktin has not mentioned how that violation affected his defense or prejudiced him in any way. See Fed.R.Evid. 103(a).

VII.
Conclusion

For the reasons stated above, we REVERSE Kehoe's, Bailey's, and Lang's convictions. We also REVERSE Ticktin's convictions on Counts Five, Six, and Seven (the Orland Park mail fraud counts). We AFFIRM Ticktin's convictions on all other counts. We REMAND to the district court with instructions to enter judgments of acquittal on all reversed convictions, and to resentence Ticktin on his remaining convictions.

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sentencing under §657 - guidelines consider loss to be amt of $ actually at risk or actually taken.

UNITED STATES of America, Plaintiff-Appellant,
v.
Janet Rebecca JOHNSON, Defendant-Appellee.

No. 92-3318.

United States Court of Appeals,
Eighth Circuit.

Submitted April 14, 1993.

Decided May 25, 1993.

Defendant was convicted in the United States District Court for the Southern District of Iowa, Ronald E. Longstaff, J., of embezzlement and **misapplication** of credit union funds by credit union employee. United States appealed denial of sentencing enhancement under Sentencing Guidelines for defendant's **misapplication** of credit union funds. The Court of Appeals, Floyd R. Gibson, Senior Circuit Judge, held that credit union's "loss" did not include misapplied funds, as they were never removed from credit union.

Affirmed.

EMBEZZLEMENT ⇐ 52
146k52
Under Sentencing Guidelines, "loss," for purposes of calculating sentence of credit union employee convicted of embezzlement and **misapplication** of credit union funds, did not include funds that she misapplied by transfer from one account to another; that money was never actually removed from credit union accounts, and credit union was not "at risk" to lose it. U.S.S.G. §§ 2B1.1, 2B1.1, comment. (n.2), (backg'd.), 18 U.S.C.A.App.

See publication Words and Phrases for other judicial constructions and definitions.

***1358** John D. Griffith, Asst. U.S. Atty., Des Moines, IA, argued, for plaintiff-appellant.

Steven A. Kloberdanz, Marshalltown, IA, argued, for defendant-appellee.

Before WOLLMAN, Circuit Judge, FLOYD R. GIBSON, Senior Circuit Judge and MORRIS SHEPPARD ARNOLD, Circuit Judge.

FLOYD R. GIBSON, Senior Circuit Judge.

The government appeals the district court's [FN1] denial of an additional three-level sentencing enhancement under United States Sentencing Guideline ("U.S.S.G.") § 2B1.1 due to Janet Johnson's **misapplication** of credit union funds. We affirm.

FN1. The Honorable Ronald E. Longstaff, United States District Judge for the Southern District of Iowa.

Johnson was an employee of the Lennox Credit Union of Marshalltown, Iowa from September 1977 until August, 1991. During an internal investigation in August 1991, Johnson called the credit union and admitted that she had embezzled funds from credit union accounts. Johnson then pled guilty to one count of embezzlement and **misapplication** of credit union funds by a credit union employee in violation of **18** U.S.C. § **657.** In the stipulation of facts, Johnson admitted to embezzling $88,483.41 and misapplying $318,915. Johnson misapplied the funds by transferring money from one credit union account to another credit union account. The district court sentenced Johnson under § 2B1.1 of the Guidelines on September 11, 1992. The court computed Johnson's total offense level at 14, based upon a base offense level of four, an eight-level increase because the loss amounted to over $70,000, a two-level increase for more than minimal planning, a two-level increase for abuse of trust, and a two-level reduction based on acceptance of responsibility. Based on Johnson's adjusted base offense level of 14, the district court sentenced Johnson to 15 months imprisonment and three years of supervised release.

The government argues the court erred in not increasing Johnson's offense level by eleven levels based on the total amount of "loss" to the credit union. The government argues that the proper amount of loss was $407,398.41, which includes the $88,483 in embezzled funds and the $318,915 in misapplied funds. We disagree. "Loss" is defined ***1359** as "the value of the property taken, damaged, or destroyed." U.S.S.G. § 2B1.1, comment. (n. 2). "The value of property taken plays an important role in determining sentences for theft offenses, because it is an indicator of both the harm to the victim and the gain to the defendant." U.S.S.G. § 2B1.1,

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comment. (backg'd). In this case, the amount of loss to the credit union was $88,483, which represents the amount of money actually removed from the credit union accounts. The misapplied funds were never removed from the credit union, but were transferred from one credit union account to another. [FN2] The credit union was never "at risk" to lose the misapplied funds, United States v. Brach, 942 F.2d 141, 143 (2d Cir.1991), and the district court properly excluded that figure from its calculation of loss under U.S.S.G. § 2B1.1.

FN2. See United States v. Shattuck, 961 F.2d 1012, 1017 (1st Cir.1992) (court indicated in dicta that amount of "victim loss" for sentencing purposes does not include the amount of misapplied funds that remained in bank accounts).

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Elements of willful misapplication

UNITED STATES of America, Plaintiff-Appellant,
v.
Leonard W. EVANS, Defendant-Appellee.

No. 93-2051.

United States Court of Appeals,
Tenth Circuit.

Dec. 5, 1994.

Bank president was acquitted of misapplying bank funds and making false entry in bank records, by the United States District Court for the District of New Mexico, Santiago E. Campos, J. Government appealed. The Court of Appeals, Seymour, Chief Judge, held that: (1) government failed to prove bank president's intent to injure bank, in connection with **misapplication** of bank **funds** charge; (2) sufficient evidence existed for jury to find bank president guilty of making false entries; and (3) new trial should not have been granted on false entry counts.

Affirmed, reversed in part and remanded.

[1] CRIMINAL LAW ⊜ 1134(8)
110k1134(8)
Court of Appeals reviews district court's grant of motion for acquittal under same standard that trial court applied in granting motion.

[2] BANKS AND BANKING ⊜ 509.15
52k509.15
To prove violation of statute criminalizing **misapplication** of bank **funds,** government must show that: defendant was executive officer of bank; bank was connected in some way to Federal Reserve System; defendant willfully misapplied funds of bank; and defendant acted with intent to injure or defraud that bank. 18 U.S.C.A. § 656.

[3] BANKS AND BANKING ⊜ 509.15
52k509.15
Defendant bank president was properly acquitted of willful **misapplication** of bank **funds,** in connection with failed attempt to bring insolvent bank out of insolvency, pursuant to which investors borrowed money necessary to purchase bank from bank itself, as according to its own indictment government had to prove that president acted with intent to defraud bank, i.e., that natural tendency of his actions was likely to injure bank, and it failed to do so. 18 U.S.C.A. § 656.

[4] BANKS AND BANKING ⊜ 509.10
52k509.10
Buying bank stock with money loaned by that bank is not illegal.

[5] BANKS AND BANKING ⊜ 509.10
52k509.10
False entries made by bank president and investors on loan approval and funding sheets, in connection with scheme to purchase bank by borrowing money from bank itself were "material," for purposes of statute criminalizing bank officer's making of false entries in book, report, or statement of bank with intent to deceive any agent or examiner; evidence was sufficient to support conclusion that president actively concealed nature of loans so that bank examiners would not realize source of funding. 18 U.S.C.A. § 1005.

[6] BANKS AND BANKING ⊜ 509.20
52k509.20
Under statute which criminalizes knowingly making any false statement or report on loan and credit applications, actual reliance on false entry need not be shown in order to obtain conviction, but rather, only that false entry had capacity to influence decision need be shown. 18 U.S.C.A. § 1014.

[7] CRIMINAL LAW ⊜ 1139
110k1139
Determination of materiality of false statements is legal issue which Court of Appeals reviews de novo. 18 U.S.C.A. §§ 1001, 1005.

[8] BANKS AND BANKING ⊜ 509.10
52k509.10
Whether loans for which false purposes were disclosed on loan approval and funding sheets were fully collateralized was irrelevant, for purposes of statute which criminalizes bank officer's making of false entries in book, report, or statement of bank with intent to deceive any agent or examiner, as long as books did not reflect actual state of affairs. 18 U.S.C.A. § 1005.

[9] BANKS AND BANKING ⊜ 509.25
52k509.25
Sufficient evidence existed for jury to find bank president guilty of making false entries in book,

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report, or statement of bank with intent to deceive any agent or examiner, based on false purposes disclosed on loan approval and funding sheets in connection with scheme to borrow money needed to buy bank from bank itself; funding sheets and loan approval forms specifically stated false purpose for loans, and those documents were part of loan files reviewed by office of comptroller of currency (OCC) examiners. 18 U.S.C.A. § 1005.

[10] CRIMINAL LAW ⚿ 935(1)
110k935(1)
In deciding motion for new trial, court may weigh evidence and consider credibility of witnesses in determining whether verdict is contrary to weight of evidence such that miscarriage of justice may have occurred.

[11] CRIMINAL LAW ⚿ 935(1)
110k935(1)
Power to grant new trial on ground that verdict was against weight of evidence should be invoked only in exceptional cases in which evidence preponderates heavily against verdict.

[12] CRIMINAL LAW ⚿ 935(1)
110k935(1)
Evidence did not preponderate heavily against jury verdict which convicted bank president of making false entry in a book, report, or statement of bank with intent to deceive any agent or examiner, so as to have warranted granting of new trial; funding sheets and loan approval forms specifically stated false purposes for loans, and those documents were part of loan files reviewed by office of comptroller of currency (OCC) examiners. 18 U.S.C.A. § 1005.

[13] CRIMINAL LAW ⚿ 718
110k718
Reference, in government's closing argument in prosecution of bank president for making false entry in book, report, or statement of bank with intent to deceive any agent or examiner, to savings and loan bailout and its effect on taxpayers, did not rise to level of prosecutorial misconduct; government's only reference to bailout or its effect on taxpayers was made in context of things that were "not going to be relevant" when jury made decision, was made in response to president's allegation of bad faith on part of office of comptroller of currency (OCC), and government stated shortly thereafter that fact that bank fails does not mean that banker committed a crime. 18 U.S.C.A. § 1005.

[13] CRIMINAL LAW ⚿ 723(1)
110k723(1)
Reference, in government's closing argument in prosecution of bank president for making false entry in book, report, or statement of bank with intent to deceive any agent or examiner, to savings and loan bailout and its effect on taxpayers, did not rise to level of prosecutorial misconduct; government's only reference to bailout or its effect on taxpayers was made in context of things that were "not going to be relevant" when jury made decision, was made in response to president's allegation of bad faith on part of office of comptroller of currency (OCC), and government stated shortly thereafter that fact that bank fails does not mean that banker committed a crime. 18 U.S.C.A. § 1005.

[14] CRIMINAL LAW ⚿ 919(3)
110k919(3)
Even if statement made by government in prosecution of bank president for making false entry with intent to deceive, which referred to savings and loan bailout were improper, new trial was not warranted, as remark in context did not have substantial influence on outcome of trial or leave court in grave doubt as to whether it had such effect. 18 U.S.C.A. § 1005.

***588** John J. Kelly, U.S. Atty. (Robert J. Gorence, Asst. U.S. Atty., with him on the brief), Albuquerque, NM, for plaintiff/appellant.

Glen L. Houston, Hobbs, NM, for defendant/appellee.

Before SEYMOUR, Chief Judge, McKAY, and BALDOCK, Circuit Judges.

SEYMOUR, Chief Judge.

The government appeals the district court's judgment of acquittal and alternative grant of a new trial after a jury found Defendant Leonard W. Evans guilty on all fifteen counts before it. Eight of the counts charged Mr. Evans with making a false entry in bank records in violation of 18 U.S.C. §§ 1005 and 2, and seven counts charged him with misapplying bank funds in violation of 18 U.S.C. §§ 656 and 2. The government contends that the

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judgment of acquittal was erroneous because the evidence was sufficient to convict Mr. Evans on all counts and that the district court abused its discretion in granting a new trial. We affirm the judgment of acquittal on the misapplication counts and we reverse the judgment of acquittal and the grant of a new trial on the false entry counts.

I.

Mr. Evans was the president of American Bank, N.A. of Rio Rancho. The bank was having financial difficulties, so a group of investors formed to purchase it from its owner. Mr. Evans worked with this group and was to remain as the bank's president upon completion of the change of control. The group filed the necessary application with the Office of the Comptroller of the Currency (OCC) for a change of control of the bank. This application stated that the group would acquire all of the outstanding common stock for $200,000. Additionally, the group would inject $2.5 million dollars of capital into the bank. Because of the bank's critical financial condition, the OCC ordered an independent audit. This audit showed that the bank was insolvent at the date of the examination.

In its decision letter to Mr. Evans, the OCC stated that in order to consummate the ***589** change of control, the group had to deposit $1.8 million of capital (first tier) in the bank within five days and the additional $700,000 (second tier) ten days later. After the infusion of the first tier capital, one of the second tier investors dropped out, leaving a deficiency of $450,000. This shortfall occurred around the time the money was to be deposited, and the investment group moved quickly to recruit new investors. Although the group found people who were interested in investing, the potential investors were unable to come up with the necessary cash on such short notice. Consequently, Mr. Evans and members of the investment group decided to arrange bank loans from American Bank to these investors to purchase American Bank stock. The charges against Mr. Evans are based on these loans and the use of their proceeds to purchase bank stock.

The pattern shown at trial, with slight variations, was that an investor would apply for a line of credit of about $75,000. Almost immediately after approval of the loan, the investor would draw out $50,000 and use the money to buy bank stock. In almost every case, the stock was held in trust for the investor under someone else's name. The loan approval and funding sheets for these loans reflected various purposes for the loans, none of which was to buy bank stock. The loan approval and funding sheets for four investors stated that the loan was for working capital for their businesses. Two investors' sheets stated that the loan was for debt consolidation and personal expenses. One investor's sheet claimed that the loan was for home improvement and bill consolidation, and the final investor's sheet stated that the loan was for purchasing a home. Richard Brown, an OCC examiner, testified that because the majority of the money was used to purchase bank stock, these purposes were false and would mislead a bank examiner. Rec., vol. IV, at 818-30.

The government does not argue that making loans to purchase bank stock is illegal, that any of the loans were deficient, or that the bank did not have the authority to make the loans. The government's theory is that Mr. Evans and members of the investment group schemed to deceive the OCC by hiding from regulators the fact that bank loan proceeds were being used to buy bank stock, and they thereby injured the bank by depriving it of much needed new capital.

Prior to submitting the case to the jury, the district court dismissed four counts against Mr. Evans. At the conclusion of the trial, the jury found Mr. Evans guilty on all remaining counts.

[1] The district court granted Mr. Evans a judgment of acquittal as to each count and, in the alternative, granted Mr. Evans a new trial on all counts. We review a district court's grant of a motion for acquittal under the same standard that the trial court applied when granting the motion. United States v. White, 673 F.2d 299, 301 (10th Cir.1982).

> We must view the evidence, both direct and circumstantial, in the light most favorable to the government, and without weighing conflicting evidence or considering the credibility of witnesses, determine whether that evidence, if believed, would establish each element of the crime. If the government has met that standard, we, as well as the trial court, must defer to the jury's verdict of guilty. This standard reflects a deep respect for the fact-finding function of the jury.

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Id. at 301-02 (citations omitted).

II.

[2][3] The government appeals the judgment of acquittal as to the misapplication counts under 18 U.S.C. § 656. Section 656 makes it a crime for an officer or employee of any bank to "willfully misappl[y] any of the moneys, funds or credits of such bank." To prove a violation under this statute, the government must show that "(1) the defendant was an executive officer of the bank, (2) the bank was connected in some way to the Federal Reserve System, (3) the defendant willfully misapplied the funds of the bank, and (4) the defendant acted with the intent to injure or defraud that bank." United States v. Haddock, 961 F.2d 933, 934-35 (10th Cir.) [Haddock II], cert. denied, --- U.S. ----, 113 S.Ct. 88, 121 L.Ed.2d 50 (1992).

***590** In its brief, the government states that " 'a willful **misapplication'** of bank **funds** 'occurs when **funds** are distributed under a record which misrepresents the true state of the record with the intent that bank officials, bank examiners, or the [Federal Deposit Insurance Corporation] will be deceived.' " Aplt.Br. at 28 (quoting United States v. Twiford, 600 F.2d 1339, 1341 (10th Cir.1979)); see also United States v. Davis, 953 F.2d 1482, 1493 (10th Cir.1992) (also quoting Twiford in context of **18** U.S.C. § **657,** a parallel statute protecting institutions insured by FSLIC), cert. denied --- U.S. ----, 112 S.Ct. 2286, 119 L.Ed.2d 210 (1992). The government argues that "[t]here is no requirement that the 'misapplication' itself be unlawful; what makes it criminal is that the use of bank funds occurs with the specific intent to 'injure or defraud' the bank.' " [FN1] Aplt.Br. at 28-29 (quoting Hernandez v. United States, 608 F.2d 1361, 1364-65 (10th Cir.1979) (emphasis added)).

FN1. There is case law in this circuit stating that under some circumstances, "evidence of 'an intent to deceive' supplie[s] the necessary proof of criminal intent required by section 656." United States v. Harenberg, 732 F.2d 1507, 1511-12 (10th Cir.1984); see also, Davis, 953 F.2d 1482; Twiford, 600 F.2d 1339; Bruce A. Green, After the Fall: the Criminal Law Enforcement Response to the S & L Crisis, 59 Fordham L.Rev. S155, S159 (1991) (courts have interpreted section 656 broadly, reading the section to "simply require[ ] deceitful handling of bank funds"). We need not address the relationship between intent to deceive bank examiners and intent to injure the bank, however, because the government did not argue it. More significantly, the misapplication counts in the indictment specifically charge that Mr. Evans, with "intent to injure and defraud" the bank, made loans "knowing that the loan majority of the proceeds would not be used for the purpose stated on the loan approval and funding sheets and instead the majority of the proceeds would be used to finance the Bank Investment Group's efforts to recapitalize" the bank. Aplt.App., doc. 1 at 6.

The court instructed the jury that "intent to injure or defraud the bank may be shown by [a knowing], voluntary act by the defendant, the natural tendency of which may have been to injure the bank." Rec., vol. XI, at 2312; see also United States v. Tokoph, 514 F.2d 597, 603-04 (10th Cir.1975). Mr. Evans allegedly loaned money under a false record and then used that money to recapitalize the bank. The natural tendency of loaning the money could not have been to injure the bank because the government did not attempt to prove at trial that any of the loans were not adequately collateralized or that the borrowers were not creditworthy. [FN2] In addition, the loans were made at a time when the bank had lending authority. Rec., vol. V, at 938.

FN2. In fact, at oral argument, the government asserted that the condition of the loans was not relevant to its argument.

[4] The government also did not prove that using funds borrowed from the bank to buy stock in the bank tended to injure the bank. Buying bank stock with money loaned by that bank is not illegal. The only relevant statute states that a bank may not make loans on the security of its own shares. 12 U.S.C. § 83 (1988). The loans in this case were not secured by bank stock, but by other collateral.

The government argued at trial and also on appeal that Mr. Evans intended to injure the bank by depriving it of new capital. Aplt.Br. at 29. However, the government did not prove that using the loan proceeds as bank capital would tend to injure the bank, nor that Mr. Evans knew or should have known that using these loan proceeds for part of the capital infusion would tend to injure the bank. The only testimony tending to show that the bank

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officers believed the capital had to be "new money" came from Benjamin Lee Dante, an original member of the investment group. [FN3] He testified that he thought the capital needed to be "new money, not money loaned from the bank." Rec., vol. VIII, at 1496. He claims he made this assumption only on the basis of Mr. Evans' statement that they had to "watch what we are doing ... [w]e're all going to wind up going to jail." Id. 1496-97. In addition, Mr. Dante had previously testified that they hid the true purpose of the loans from the regulators because at the time they mistakenly thought that "it was illegal for loan proceeds ***591** from the bank to be used to purchase stock." Rec., vol. VII, at 1289; see also rec., vol. VI, at 1229.

> FN3. Mr. Dante pled guilty to **misapplication** of bank **funds** before Mr. Evans' trial, but was allowed to withdraw his plea after the judgment of acquittal.

Richard Brown, the OCC examiner, testified about the consequences of not having "new money" make up all of the required capital. Rec., vol. V, at 1002-03. The first consequence, he said, was that if the OCC had known where the money came from, the OCC might not have approved the change of control application. Id. at 1002. However, this assertion only establishes that the false purpose deceived the OCC, not that the actual transaction adversely affected the bank itself. Mr. Brown also testified that under appropriate accounting, this money could not have been used to make loans. Id. at 1002-03.

In earlier testimony, Robert Norris, another OCC examiner, gave his opinion that if the $2.5 million of needed capital were not all "new money," the bank would probably fail. Rec., vol. IV, at 770-71. This statement was only presented as Mr. Norris' opinion, and the government offered no other evidence that this lack of new capital contributed or could have contributed to the bank's failure. In fact, Mr. Brown testified extensively on cross-examination that seventy-one days after the change of control took place, the examiners caused the bank to become insolvent in spite of the capital infusion by charging-off around $3.5 million dollars of loans. Rec., vol. V, at 908-28. Mr. Norris also testified that under generally accepted accounting principles, "money borrowed from the bank which is used to purchase stock in the bank would not qualify as capital. That's an accounting as well as a regulatory practice." Rec., vol. III at 604. He further stated that he would not have let the people invest their money. Id. at 605. However, he did not state how the bank itself would have been injured.

The district court asked the government whether a regulation existed that would prohibit making bank loans to investors to purchase stock in the same bank. Rec., vol. XI, at 2175. The government answered that an accounting regulation would have prohibited this money from being treated as capital. Id. at 2176. The court told the government to produce the regulation. Id. The government went on to state: "It could have been done if it was disclosed and the OCC says [sic] yes, but the regulation says they could not count this as part of the new paid[-in] capital." Id. It does not appear from the record that the government ever produced the regulation; nor has the government cited any such regulation to us on appeal.

In sum, the government had to prove, according to its own indictment, that Mr. Evans acted with intent to defraud the bank, i.e., that the natural tendency of his actions was likely to injure the bank. The government did not meet this burden. The government presented sufficient evidence that had the loan approval and funding sheets stated that the proceeds of the loans were used to buy bank stock, the OCC might not have approved change of control. This evidence, however, is not sufficient to prove that Mr. Evans intended to injure or defraud that bank. The bank was insolvent when the investment group submitted its change of control application. The OCC examiners approved the application contingent upon the infusion of $2.5 million of bank capital. According to the government, that infusion did not fully take place because the bank loans were not "new" capital, and had the OCC examiners known it in time, they might not have approved the change of control. The government does not address the fact that if the OCC had not approved the change of control, the bank would have remained in its original insolvent condition. In fact, seventy-one days after the $2.5 million was injected, OCC examiners charged-off bank loans totaling around $3.5 million. These charge-offs returned the bank to its insolvent position, despite the $2.5 million capital infusion, so the OCC closed the bank.

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In sum, Mr. Evans and the investors tried to bring the bank out of insolvency but failed in their attempt, and the investors lost $2.5 million. The government's theory that Mr. Evans intended to injure the bank by arranging to supply $450,000 of capital that was not "new" is thus untenable. We therefore affirm the district court's judgment of acquittal on these counts.

***592** III.

The false entry counts charge Mr. Evans with violating 18 U.S.C. § 1005. This section criminalizes a bank officer's "false entry in any book, report, or statement [of certain banks] with intent to ... deceive ... any agent or examiner." In granting the judgment of acquittal, the district court stated that "[t]he false entry must pertain to material information," Aplt.App., doc. 2 at 10, and then found that the entries, "if false, were not material," id. at 11.

[5][6][7] We need not decide whether Congress intended that a false entry under section 1005 be material because we hold that the false entries made in this case were material. In the context of other false statement statutes, we have defined materiality as "a natural tendency to influence, or the capability of influencing" a decision maker. United States v. Daily, 921 F.2d 994, 1003 n. 9 (10th Cir.1990) (construing 18 U.S.C. § 1001, which forbids the "mak[ing] of any false, fictitious or fraudulent statements or representations to government officials"), cert. denied, --- U.S. ----, 112 S.Ct. 405, 116 L.Ed.2d 354 (1991); see also United States v. Haddock, 956 F.2d 1534, 1550 (10th Cir.1992) [Haddock I] (construing 18 U.S.C. § 1014, which criminalizes "knowingly mak[ing] any false statement or report on loan and credit applications"). Actual reliance on the false entry need not be shown, only that it "had the capacity to influence" the decision. Haddock I, 956 F.2d at 1550. The determination of materiality is a legal issue which we review de novo. See United States v. Brittain, 931 F.2d 1413, 1417 (10th Cir.1991) (construing 18 U.S.C. § 1001).

Courts have held in other contexts that stating a false loan purpose is material. The Eighth Circuit, which recognizes materiality as an essential element of a section 1001 violation, upheld a conviction under the statute in a situation very similar to the instant case. United States v. Whitaker, 848 F.2d 914, 916 (8th Cir.1988). In Whitaker, the court held that false statements made by a bank president to a Federal Deposit Insurance Corporation examiner concerning the use of loan proceeds were material. During a visit by the examiner, the defendant told him that the proceeds of certain loans were to be used for business purposes, with only some of the proceeds to be used to buy "penny" stock. Id. at 915. In actuality, all of the funds were used to purchase stock. At the time the defendant made these statements, the bank examiner already had information from a confidential source and from the bank's records which alerted him to the fact that the loans were suspicious. The defendant argued that because the examiner already knew the loans were suspect, his statements could not have influenced the examiner. Id. at 916. The examiner testified at trial that had he known the true purpose of the loans, he would have inquired into the matter further and recommended that practice of making these types of loans be stopped immediately. Id. The court held that the false statements about the purpose of the loans were thus material because they had the " 'capacity of influencing' the decisions of the FDIC." Id. [FN4]

> FN4. The facts in the present case suggest that the misrepresentation by Mr. Evans was more material than that made by Mr. Whitaker. Mr. Whitaker claimed that some of the loan proceeds would go to purchase bank stock but then used all of the money for that purpose. The loan approval and funding sheets in the present case, however, did not even mention the possibility that the money would be used to purchase stock.

Other courts have held that making false statements about the purpose of a loan is material under section 1014, which criminalizes making a false statement "for the purpose of influencing in any way the action of [certain banking entities]." Under this section, various circuits have held "that the stated purpose of a loan is a material fact." United States v. Van Dyke, 820 F.Supp. 1160, 1163 (N.D.Iowa 1993) (citing cases), rev'd on other grounds, 14 F.3d 415 (8th Cir.1994). The Seventh Circuit upheld a conviction under section 1014 when the defendant "falsely stated the purpose of the loan." United States v. Shively, 715 F.2d 260, 264 (7th Cir.1983), cert. denied, 465 U.S. 1007, 104 S.Ct. 1001, 79 L.Ed.2d 233 (1984). The court

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stated:

> There is no question that by signing a promissory note which contained a statement ***593** that he knew was false (that the purpose of the loan was "business expense and marketing operation") [the defendant] was making a false statement within the meaning of the statute.

Id.

[8] Cases construing section 1005, at issue here, also support the conclusion that false entries with regard to loan purposes are material. The Ninth Circuit upheld a conviction under the statute where the jury found that the "bank's records of the loans were false in that they did not reflect either the true borrower or the actual purpose of the loans." U.S. v. Wolf, 820 F.2d 1499 at 1504 (9th Cir.1987). The Third Circuit was faced with an analogous situation under the statute in United States v. Krepps, 605 F.2d 101 (3d Cir.1979). In that case, the bank's books showed loans to two separate parties, but did not show that the defendant, an officer of the bank, was the ultimate beneficiary of the loans. Krepps, 605 F.2d at 109. The court held it did not matter that the named debtors were capable of repaying the loan and recognized their legal obligation to do so.

> [T]he fact that there is no evidence demonstrating that the named debtors are incapable of repaying the loans, or that they deny their legal obligation to do so, does not shield the true nature of the transactions.... Because those who are charged by law with the examination of these records have a significant interest in obtaining a full picture of the bank's actual condition ... the true nature of the transaction should have been entered in the bank's records.

Id. The Third Circuit's reasoning applies to the instant case as well. Whether the loans were fully collateralized is irrelevant as long as the books did not reflect the actual state of affairs. The evidence is sufficient to support the conclusion that Mr. Evans actively concealed the nature of the loans so that the examiners would not realize the source of the second tier financing.

[9] The evidence presented at Mr. Evans' trial supports our conclusion that the entries were material. Richard Brown, an OCC national bank examiner, testified that if the true purposes of the loans had been listed on the funding sheets, he would have notified the OCC in Dallas. Rec., vol. V, at 846-47. He also testified that when he realized what the true purpose of the loans was, he did notify Bob Norris in the OCC office. Id. at 847. He said that the purpose of loans is important in general, id. at 856-57, and that the purpose of the loans was particularly important in this case because it had "a direct impact upon the balance sheet of the bank." Id. at 1000. In addition, he testified that had the loans been reflected accurately, the OCC might not have approved the application. Id. at 1002. Mr. Norris testified that the OCC might not have allowed the change in control if it had known that part of the second tier money was actually coming from loans made by the bank. Rec., vol. III, at 600. Sufficient evidence existed for the jury to find Mr. Evans guilty of the false entry violations. The judgment of acquittal therefore is reversed.

IV.

Because we have reversed the district court's judgment of acquittal on the false entry counts, we must address the district court's alternative grant of a new trial on those counts. "We review the trial court's grant or denial of a motion for new trial under the abuse of discretion standard." United States v. Muldrow, 19 F.3d 1332, 1339 (10th Cir.1994). The district court gave several reasons for granting a new trial. We address all but the one relating to improper jury instructions, which pertains only to the misapplication counts on which we have affirmed the judgment of acquittal.

[10][11] The district court held that the verdict was against the weight of the evidence. As the court noted, "[i]n deciding a motion for new trial, the court may weigh the evidence and consider the credibility of witnesses in determining whether the verdict is contrary to the weight of the evidence such that a miscarriage of justice may have occurred." Aplt.App., doc. 2 at 13. The court went on to state that " 'the power to grant a new trial on this ground should be invoked only in exceptional cases in which the evidence preponderates heavily against the verdict.' " ***594** Id. (quoting 3 C. Wright, Federal Practice & Procedure, § 553, at 248 (2d ed. 1982)). The district court stated the correct standard, but we disagree that the evidence in this case preponderates heavily against the verdict.

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[12] The court determined that the verdict on the false entry charges was against the weight of the evidence because the loan applications established revolving lines of credit which "can be used for any legal purpose unless there is a specific restriction on it. None of these lines of credit had restrictions." Aplt.App., doc. 2 at 13-14. Although the promissory notes that were signed by the loan applicants described these loans as revolving lines of credit, the funding sheets and loan approval forms specifically stated false purposes for the loans. Mr. Evans argues that the promissory notes were the controlling documents because they were the only documents legally binding on the loan applicants. The loan funding and approval sheets, however, were part of the loan file which the OCC examiners reviewed. See rec., vol. XI, at 2188-91. These documents contained purposes which could not be read to authorize use of the proceeds to purchase bank stock. See rec., vol. IV, at 818-30. It is irrelevant for purposes of the false entry statute that the customers did not see these documents and were not bound by them, or that the purposes of the loans as stated in other documents in the file were broad enough to allow the money to be used to buy stock. It only matters that false entries which would deceive examiners were made in documents in the bank files.

The district court also said "there was strong evidence that the defendant acted in good faith in all respects.... The government did not negate the defendant's good faith and prove that he acted in bad faith." Aplt.App., doc. 2 at 14. We disagree. The evidence the government presented that Mr. Evans entered false purposes of the loans into the bank records with the intent to deceive the bank examiners was sufficient evidence for a jury to find that Mr. Evans acted in bad faith. Moreover, the government introduced other specific evidence that Mr. Evans did not act in good faith. Cindy Richards, vice-president of loan operations for the bank, produced the loan documents at the request of Mr. Evans. When she asked Anthony Aguilar, the bank's loan officer, what to put for the purpose of the loans, he said " 'I don't care, just put something.' " Rec., vol. VI, at 1118. See id. at 1125. She acknowledged that Mr. Evans' initials appeared on the loan approval and funding sheets. Id. at 1128-36. She also recalled Mr. Evans stating at a board meeting, "[w]hat we're doing here is not exactly kosher." Id. at 1144. Laura Shaefer, who worked as Mr. Evans' personal secretary, also testified that Mr. Evans stated that "what we had done quote, 'was not exactly kosher,' unquote." Id. at 1194. The district court abused its discretion in granting a new trial on this ground because the evidence does not weigh heavily against the jury's verdicts on the false entry counts.

[13] The district court further concluded that a new trial was warranted because "the government's closing argument was unduly prejudicial in that it referred to the multibillion dollar savings and loan bailout and its effect on taxpayers." Aplt.App., doc. 2 at 14. The court believed that this reference was inappropriate because the bank's insolvency had nothing to do with Mr. Evans' actions. Id. We have reviewed the closing argument, and the government's only reference to the savings and loan bailout or its effect on taxpayers was made in the context of "things that I submit really are not going to be relevant when you go in that jury room to make your determination as to that man's guilt or innocence." Rec., vol. XI, at 2320. The government made this reference during its reply to Mr. Evans' allegation of bad faith on the part of the OCC. Id. at 2322. The government explained that Congress had mandated that the OCC look at how a change of control will affect taxpayers and try to "avoid the same spectacle with commercial banks or nationally chartered banks as has happened with the S and L's and the $200 billion plus losses [that happened] there." Id. at 2323. A few sentences later the government said, "[i]f a bank fails that doesn't mean the banker committed a crime." Id.

***595** [14] Given the context in which the statement about the savings and loan failure was made, the statement does not rise to the level of prosecutorial misconduct. Even if the statement were improper, a new trial is not warranted because the remark in context could not have had a " 'substantial influence' on the outcome" of the trial or leave us "in 'grave doubt' as to whether it had such effect." United States v. Rivera, 900 F.2d 1462, 1469 (10th Cir.1990) (en banc). Consequently, we hold that the district court's grant of a new trial on the false entry counts was an abuse of discretion.

We AFFIRM the judgment of acquittal on the misapplication counts. We REVERSE the judgment of acquittal and the grant of a new trial on the false

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entry counts, and we REMAND for sentencing in accordance with the jury verdict.

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"connected to" an institution as element of 18 USC § 657

UNITED STATES of America, Appellee,
v.
Frederick Charles BOLSTAD, Jr., Appellant.

No. 92-3725.

United States Court of Appeals,
Eighth Circuit.

Submitted May 10, 1993.

Decided July 12, 1993.

Defendant was convicted in the United States District Court for the District of Minnesota, Donald D. Alsop, J., of misapplication of savings and loan funds and fraudulent participation in loan, and he appealed. The Court of Appeals held that: (1) defendant was sufficiently related to savings and loan to fall under statutes prohibiting misapplication of funds and fraudulent participation in loan; (2) evidence was sufficient to show intent to defraud savings and loan; and (3) any error in instructing on willful blindness was harmless.

Affirmed.

[1] BUILDING AND LOAN ASSOCIATIONS ⇐ 23(8)
66k23(8)
Defendant who was president of wholly owned subsidiary of savings and loan and was responsible for preparing and presenting loan documents to savings and loan was "connected" with savings and loan for purposes of statutes prohibiting anyone connected in any capacity with savings and loan from misapplying savings and loan funds and fraudulently participating in loan. 18 U.S.C.A. §§ 657, 1006.

See publication Words and Phrases for other judicial constructions and definitions.

[2] BUILDING AND LOAN ASSOCIATIONS ⇐ 23(8)
66k23(8)
Evidence in prosecution of president of subsidiary of savings and loan for misapplying savings and loan funds and fraudulent participation in loan was sufficient to show intent to defraud savings and loan; evidence included proof that defendant knew that loan proceeds could only be used for buying and developing real estate, that defendant structured two-part transaction to artificially increase real estate's purchase price, that defendant lied to savings and loan about actual price, and that he did not tell savings and loan that he was partner of subsequent transferee of real estate or that he received part of loan proceeds for personal use. 18 U.S.C.A. §§ 657, 1006.

[3] CRIMINAL LAW ⇐ 1172.1(3)
110k1172.1(3)
Any error in giving willful blindness instruction was harmless in prosecution arising from fraud on savings and loan; defendant did not ask trial court to limit instruction to the other defendant, government never asserted that instruction applied to defendant during closing argument, and evidence of defendant's criminal intent was overwhelming. 18 U.S.C.A. §§ 657, 1006.

***597** Virginia Villa, Minneapolis, MN, Katherian D. Roe, (on the brief), for appellant.

James E. Lackner, Minneapolis, MN, argued, for appellee.

Before RICHARD S. ARNOLD, Chief Judge, LAY, Senior Circuit Judge, and FAGG, Circuit Judge.

PER CURIAM.

Frederick Charles Bolstad, Jr., appeals his jury convictions for misapplication of savings and loan funds and fraudulent participation in a loan in violation of 18 U.S.C. § 657 and § 1006. We affirm.

***598** Bolstad was the president of Midwest Federal Mortgage Corporation (MFM), a wholly owned subsidiary of Midwest Federal Savings and Loan (MFS & L). Bolstad was responsible for originating commercial real estate loans, gathering the documentation, and presenting the documents to MFS & L for approval. Unknown to MFS & L, Bolstad was also a partner of CDR/Minnesota, a real estate development company. One of Bolstad's responsibilities for CDR/Minnesota was to obtain financing for its development projects.

In 1985, CDR/Minnesota agreed to purchase some real estate. Bolstad structured the purchase as a

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Defrauding the SBIC program.
applies §§ 1001, 1006, 1343, 371

UNITED STATES of America Plaintiff-Appellee,
v.
Herman K. BEEBE, Sr. and Dale A. Anderson, Defendants-Appellants.

No. 85-4428.

United States Court of Appeals, Fifth Circuit.

June 30, 1986.

Defendants were convicted on three counts of defrauding the Small Business Administration in the United States District Court for the Western District of Louisiana, Tom Stagg, Chief Judge. Defendants appealed. The Court of Appeals, W. Eugene Davis, Circuit Judge, held that: (1) count which informed defendants that illegal benefit they received was their participation in $100,000 loan was sufficient, and (2) evidence was sufficient to sustain convictions in that reasonable jurors could have concluded beyond a reasonable doubt that defendants, as officers of small business investment company, set up sham corporation with intent to defraud.

Affirmed.

[1] INDICTMENT AND INFORMATION ⇦ 71.2(1)
210k71.2(1)
To be sufficient, indictment must fairly inform defendant of charge against which he must defend and enable him to plead double jeopardy in future prosecutions of same offense. U.S.C.A. Const.Amend. 5.

[2] INDICTMENT AND INFORMATION ⇦ 117
210k117
Indictment's validity is determined by practical, not technical, reading of indictment as whole.

[3] INDICTMENT AND INFORMATION ⇦ 110(3)
210k110(3)
Generally, indictment is sufficient when charge tracks governing statute as long as statutory language unambiguously sets forth all essential elements; otherwise, if statute defines offense in generic terms, indictment must descend to particulars.

[3] INDICTMENT AND INFORMATION ⇦ 110(4)
210k110(4)
Generally, indictment is sufficient when charge tracks governing statute as long as statutory language unambiguously sets forth all essential elements; otherwise, if statute defines offense in generic terms, indictment must descend to particulars.

[4] INDICTMENT AND INFORMATION ⇦ 71.4(4)
210k71.4(4)
Count which informed defendants, who were chairman and vice-chairman of corporation's board, that illegal benefit they received was their participation in $100,000 loan from corporation licensed by Small Business Administration as small business investment company was sufficient, notwithstanding contention that that count of indictment was impermissibly vague because it failed to specify illegal "benefit" which defendants allegedly received in connection with loan.

[5] INDICTMENT AND INFORMATION ⇦ 121.1(3)
210k121.1(3)
District court did not abuse discretion when it denied request for bill of particulars, in that indictment was sufficient.

[6] CRIMINAL LAW ⇦ 1038.2
110k1038.2
Trial court did not commit plain error in failing to warn jury against Government's supposed new theory of benefit, where, throughout trial and in closing argument, Government argued that defendants benefitted from $100,000 loan because borrowing corporation was sham setup for second corporation's benefit.

[7] FRAUD ⇦ 69(5)
184k69(5)
Reasonable jurors could have concluded beyond reasonable doubt that borrowing corporation was sham setup for second corporation's benefit, so as to support conviction of benefitting from specific Small Business Administration loans; borrowing corporation was reactivated at defendant's request, corporation's stock was all issued to president at no cost, and president knew nothing about management or affairs of corporation and performed only

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investment company **(SBIC). SBIC's** are private lending institutions which are licensed by the SBA. If the **SBIC** follows the regulations and restricts its loans to qualified business concerns--generally those with a relatively minimal net worth--the **SBIC** is eligible to receive "leveraged" financing through debt instruments purchased or guaranteed by the SBA. However, before it can apply for this financing, the **SBIC** must obtain private investment capital and loan these funds to qualified borrowers. Once the officer of the **SBIC** certifies that the privately generated funds have been loaned to qualified borrowers, the SBA will generally replenish the **SBIC** coffers with funds up to three times the amount of the **SBIC's** private capital. See 13 C.F.R. § 107 (1986).

The license application submitted by SVCC certified that it received $1,000,000 in private capital from Savings Life Insurance Company in return for 100% of its stock. Savings Life is a corporation wholly owned by AMI, Inc. After receiving the private capital, SVCC made numerous loans to small business concerns and qualified for and received SBA financing. At all relevant times, appellant Beebe was chairman of AMI's board and appellant Anderson was vice-chairman. Additionally, Beebe was a director of SVCC and Anderson was its president.

In November 1980, AMI contracted to buy from Christian Care, Inc., a leasehold interest in the San Jacinto Nursing Home located in Deer Park, Texas, for $100,000. Pursuant to the contract, AMI gave Christian Care a $25,000 deposit and was required to complete the purchase on December 29, 1980. However, AMI assigned the contract to American Medical Management Corporation (AMMC), an entity that was at least facially qualified to borrow from a **SBIC.** On December 29, 1980, SVCC loaned $100,000 to AMMC and AMMC used the proceeds of the loan to purchase the leasehold interest in the San Jacinto Nursing Home. After buying the leasehold interest, AMMC entered into an agreement with AMI whereby AMI agreed to manage the nursing home for a fee.

AMMC was initially incorporated in 1977 by George Owen, a business associate and personal friend of appellant Beebe, as a vehicle to acquire and operate hospitals. This venture, financed by Owen and Beebe, was shortlived and AMMC became inactive. On December 29, 1980--the same day AMMC acquired the interest in the San Jacinto Nursing Home--David Robinson, Owen's personal bookkeeper, was made president of AMMC. All of AMMC's stock was issued to Robinson without any investment or personal obligation on his part. Robinson had no experience operating nursing homes and knew nothing about the ***1366** affairs of AMMC. Robinson's only duties, for which he received $500 a month, involved ministerial tasks assigned to him by AMI officers.

George Owen also knew nothing about AMMC's financial affairs, had no duties and held no stock in AMMC although he testified that he expected to profit if AMMC was successful. He did receive a $1,000 per month "consulting" fee to help defray expenses incurred in the use of his Dallas apartment by Beebe and other AMI officers. After suffering losses for two years, AMMC's stock was acquired by Louisiana Nursing Homes, Inc. (LNH), a corporation effectively owned by Beebe's children, in exchange for the cancellation of a debt owed to LNH. The government proceeded against appellants in Count 5 on the theory that AMMC was a sham corporation through which SVCC loaned $100,000 to AMI for appellants' benefit in violation of **18** U.S.C. § **1006.**

II. SUFFICIENCY OF THE INDICTMENT

[1][2][3] To be sufficient, an indictment must fairly inform the defendant of the charge against which he must defend and enable him to plead double jeopardy in future prosecutions of the same offense. Hamling v. United States, 418 U.S. 87, 117, 94 S.Ct. 2887, 2907, 41 L.Ed.2d 590 (1974). The indictment's validity is determined by a practical, not technical, reading of the indictment as a whole. United States v. Webb, 747 F.2d 278, 284 (5th Cir.1984), cert. denied, --- U.S. ----, 105 S.Ct. 1222, 84 L.Ed.2d 362 (1985). Generally, an indictment is sufficient when the charge tracks the governing statute as long as the statutory language unambiguously sets forth all essential elements, United States v. Gordon, 780 F.2d 1165, 1169 (5th Cir.1986); otherwise, if the statute defines the offense in generic terms, the indictment "must descend to particulars." Russell v. United States, 369 U.S. 749, 765, 82 S.Ct. 1038, 1047, 8 L.Ed.2d 240 (1962).

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[4] Appellants contend that Count 5 of the indictment is impermissibly vague because it fails to specify the illegal "benefit" which they allegedly received in connection with the $100,000 loan to AMMC. [FN3] However, Count 5 did inform appellants that the illegal benefit they received was their participation in the $100,000 loan from SVCC to AMMC. Under the established law of this circuit, the indictment is sufficient. [FN4]

FN3. Count 5 of the indictment alleges: On or about the 31st day of December 1980, in the Western District of Louisiana, [appellants], being officers, directors, employees, agents, or connected in a capacity with SVCC, a Small Business Investment Company, duly licensed by the SBA, with intent to defraud said SBA, did unlawfully and willfully participate, share in, and directly and indirectly receive monies and benefits by means of and through the disbursement by SVCC of a wire transfer in the amount of $100,000 drawn against the SVCC account at Bossier Bank and Trust Co. for benefit of American Medical Management Corporation, the same representing proceeds of a purported legitimate loan from SVCC to American Medical Management Corporation.

FN4. Appellants urge that we should find Count 5 insufficient because a similarly worded count in an indictment alleging a violation of **18** U.S.C. § **1006** was found deficient in United States v. Quinn, 365 F.2d 256 (7th Cir.1966). Appellant's reliance on Quinn is misplaced. That court was not concerned with the adequacy of the description of benefit; the court there found that Count II of the indictment contained "no allegation as to the manner or means employed in receiving money, profits and benefits, or that the check described was issued without proper authority." Id. at 262. To the extent that Quinn can be read to support appellant's view that more detail is required in the indictment at issue, we decline to follow it.

[5][6] Appellants also complain that before the trial the district court denied their request for a bill of particulars requesting information regarding the illegal benefit they received and argue that this ruling constituted reversible error. Because the indictment was sufficient, the district court did not abuse its discretion when it denied appellants' request for a bill of particulars. ***1367** [FN5] United States v. Chenaur, 552 F.2d 294, 302 (9th Cir.1977).

FN5. Appellants additionally complain that that ambiguity of the indictment and the jury instructions allowed the jury to conclude that the illegal "benefit" appellants received was the legitimate management fee paid to AMI pursuant to its contract with AMMC to operate the San Jacinto Nursing Home. They refer to three questions asked by the government on cross-examination of appellant Anderson which they argue introduced this new theory of "benefit" to the jury. Appellants in effect contend that the trial judge failed to instruct the jury that the management fee could not be considered an "illegal benefit" under section 1006. However, appellants failed to request such a jury instruction or seek an appropriate cautionary instruction during cross-examination. At the charge conference, defense counsel specifically declined to request any such instruction upon being informed that the government had no intention of asserting this theory of benefit. Throughout the trial and in its closing argument, the government argued that appellants benefitted from the $100,000 loan described in Count 5 because AMMC was a sham corporation set up for AMI's benefit. Therefore, we conclude that the trial court did not commit plain error in failing to warn the jury against the government's supposed new theory of benefit.

III. SUFFICIENCY OF THE EVIDENCE

Appellants argue that the evidence does not support their convictions on Count 5 because it fails to establish that AMMC was a sham corporation. Alternatively, Anderson contends that the evidence fails to prove that he had knowledge of this fact. On review, we consider whether the evidence viewed favorably toward the verdict could establish guilt beyond a reasonable doubt in the mind of a reasonable trier of fact. United States v. Hernandez, 731 F.2d 1147, 1149 (5th Cir.1984).

[7] Appellants' first contention lacks merit. A review of the record persuades us that reasonable jurors could conclude beyond a reasonable doubt that AMMC was set up as a sham corporation for AMI's benefit. AMMC was reactivated at appellant Beebe's request. David Robinson was made president of AMMC at Owen's suggestion and all of its stock was issued to Robinson at no cost. Robinson admitted that he knew nothing about the

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management or affairs of AMMC and performed only those ministerial duties assigned him by AMI personnel.

Appellants assert that Robinson held the AMMC stock for Owen's benefit and that Owen was the true owner of AMMC. Although Owen testified that he expected to profit if AMMC was profitable, he did not invest any funds in AMMC, did not perform any duties on behalf of AMMC, and knew nothing of AMMC's financial affairs. The only payment Owen received from AMMC was $1,000 a month which he testified Beebe obtained for him from AMMC to help pay for the use of his apartment by AMI officers. Ultimately, AMMC's stock was acquired by LNH, a corporation effectively owned by Beebe's children.

Appellants insist that the evidence is entirely consistent with their contention that AMI did not control AMMC at the time of the SVCC loan, and that Robinson and Owen were placed in the role of passive investors by AMMC's management agreement with AMI. This argument is misplaced. "It is not necessary that the evidence exclude every reasonable hypothesis of innocence or be wholly inconsistent with every conclusion except that of guilt, provided a reasonable trier of fact could find that the evidence establishes guilt beyond a reasonable doubt." United States v. Bell, 678 F.2d 547, 549 (5th Cir.1982), aff'd., 462 U.S. 356, 103 S.Ct. 2398, 76 L.Ed.2d 638 (1983). Here, the jury was "free to choose among reasonable constructions of the evidence" and properly did so. Id.

[8] Similarly, Anderson's argument that the evidence fails to prove his intent to defraud the SBA is meritless. At the time of the SVCC loan to AMMC, Anderson was a board member of AMI and president of SVCC. He signed a resolution authorizing AMI to assign the San Jacinto Nursing Home contract to AMMC and admitted ***1368** knowing that AMI had contracted with AMMC to manage the nursing home. He approved the SVCC $100,000 loan to AMMC and was aware that the money would be used to purchase the nursing home leasehold interest. Although he testified that he believed George Owen owned AMMC and that the transaction was proper, the jury was entitled to infer from the evidence that Anderson was aware that AMMC was a sham corporation and approved the SVCC loan with intent to defraud the SBA.

IV. JURY INSTRUCTION

Appellants requested the trial judge to instruct the jury that good faith on their part is a complete defense to all counts of the indictment. The trial judge gave a good faith defense instruction but limited it to the charges of wire fraud and filing false statements contained in Counts 6-12.

[9] The parties agree that the applicable law in this circuit establishes that an accused is ordinarily entitled to a good faith defense instruction when intent to defraud is an element of the offense charged and the defense is fairly raised by the evidence. United States v. Goss, 650 F.2d 1336 (5th Cir.1981); United States v. Fowler, 735 F.2d 823 (5th Cir.1984). However, failure to give the instruction is not reversible error if intent is properly defined in the charge to exclude a good faith belief and defense counsel presents the substance of this defense to the jury in closing argument. United States v. Fooladi, 746 F.2d 1027, 1030 (5th Cir.1984), cert. denied, --- U.S. ---, 105 S.Ct. 1362, 84 L.Ed.2d 382 (1985); United States v. Gray, 751 F.2d 733, 735 (5th Cir.1985).

[10] In light of this authority, appellants do not argue that the trial judge's failure to give a good faith defense instruction for Counts 1 and 5 demands reversal. Rather, they contend that the court's instruction approving a good faith defense for Counts 6-12 allowed the jury to infer that good faith was not a defense to Counts 1 and 5. We are not persuaded by this ingenious argument. It is unrealistic to believe that the jury would place such emphasis on a single sentence in a lengthy charge. The government did not argue to the jury that good faith was not a defense to Counts 1 and 5; in closing argument both the prosecution and the defense focused on whether the defendants acted in good faith. This issue was squarely put to the jury which decided it against the defendants.

V. CONCLUSION

Having rejected appellants' points of error on Count 5 of the indictment, we need not consider their contingent arguments relating to their convictions on Counts 1 and 12. The judgment of the district court is

AFFIRMED.

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indictment / conviction - fraud, false statements to SBA

reversed due to bad reas. doubt instruction.

UNITED STATES of America, Plaintiff/Appellee,
v.
Harold T. WOSEPKA, Defendant/Appellant.

No. 83-3117.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted March 5, 1985.

Decided April 9, 1985.
As Modified July 9, 1985. [FN*]

FN* The order modifying this opinion is published at 787 F.2d 1294.

Defendant was convicted in the United States District Court for the Western District of Washington, Jack E. Tanner, J., of mail and wire fraud, false statements, and misapplying funds of small business investment company, and he appealed. The Court of Appeals, Ferguson, Circuit Judge, held that reasonable doubt instruction given by district court was inadequate.

Reversed and remanded.

[1] CRIMINAL LAW ⇐ 822(16)
110k822(16)
If district court's reasonable doubt charge, taken as a whole, does not fairly and accurately convey meaning of reasonable doubt, conviction must be reversed.

[2] CRIMINAL LAW ⇐ 789(2)
110k789(2)
Court's instruction on reasonable doubt, merely stating that reasonable doubt "is a doubt based on reason and common sense," and deleting critical language defining reasonable doubt in terms of "hesitation to act" and requiring jurors to decide question of guilt or innocence with same degree of care and attention they would bring to bear "in the most important of their own personal affairs" failed to provide jury with any meaningful principles or standards to guide it in evaluating sufficiency of Government's evidence.

[3] POSTAL SERVICE ⇐ 35(6)
306k35(6)
To establish offense of mail fraud, in addition to scheme to defraud, government must prove beyond reasonable doubt that defendant caused use of United States mails to execute scheme. 18 U.S.C.A. § 1341.

*1007 Robert Westinghouse, Harry McCarthy, Asst. U.S. Attys., Seattle, Wash., for plaintiff-appellee.

Mark O. Heaney, Los Angeles, Cal., for defendant-appellant.

Appeal from the United States District Court for the Western District of Washington.

Before FARRIS, ALARCON and FERGUSON, Circuit Judges.

FERGUSON, Circuit Judge:

The defendant, Harold T. Wosepka, contends that his convictions for mail and wire fraud, 18 U.S.C. §§ 1341, 1343, false statements, 18 U.S.C. § 1001, and misapplying the funds of a small business investment company, **18** U.S.C. § **657,** should be reversed because, inter alia, the reasonable doubt instruction given by the district court was inadequate. Given the circumstances of this case, we agree and reverse.

I.

The charges upon which Wosepka was convicted arose out of Wosepka's participation in a loan program operated by the Small Business Administration ("SBA") pursuant to the Small Business Investment Act of 1958 (the "Act"). 15 U.S.C. §§ 681-687.

Under the Act, the SBA is authorized to license privately owned investment companies with sufficient capital from private funds as Small Business Investment Companies (**"SBIC"s).** The purpose of an **SBIC** is to provide equity capital, long-term loans and management assistance to small business concerns. When adequately capitalized by private funds, an **SBIC** may gain access to SBA funds in amounts equal to up to four times the private capital of the **SBIC.** These SBA funds, known as "leverage funds," are provided in the form of a loan, typically for a ten year period, at interest rates determined by the Treasury Department's cost

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of funds. Although it is independent and privately owned, an **SBIC** is subject to reporting requirements and annual examinations by the SBA. In short, an **SBIC** is a federally regulated investment company which lends the government's money as well as its own to small business concerns.

In 1978, Wosepka purchased all the stock of an **SBIC** named the Small Business Investment Company of America (the "Company"). After acquiring the Company, Wosepka sought the approval of the SBA for the transfer of ownership and control. Because the Company had been inactive for some time, the SBA required a fresh injection of private capital as a condition of any transfer of ownership.

In order to satisfy the SBA's requirement, Wosepka made a $268,719 deposit to the Company's account. This deposit was made possible by a complicated series of transactions which the government terms a "check kite"--a circular flow of nonsufficient funds checks culminating in an illusory deposit--and which Wosepka terms a valid series of close business transactions with real cash injected from a line of credit.

Wosepka then, on March 23, 1979, sent a letter to the SBA representing that a capital increase had been made and enclosing a balance sheet for the Company and a bank verification letter confirming that an unencumbered cash deposit of $268,719 had been made to the Company's account. Because of the private cash increase to the capital base of the Company, the SBA approved the license transfer to Wosepka and the Company also qualified for SBA leverage funding.

***1008** The Company, with its name changed to Trans-Am Bancorp, Inc. ("Trans-Am"), applied for leverage funds on March 27, 1979 ($500,000), August 9, 1979 ($450,000), August 30, 1979 ($500,000), and October 31, 1979 ($500,000). All applications were approved and funds totalling $1.95 million were wired by the SBA in four increments to Trans-Am's bank account in Oregon. The government claims that Wosepka then set up various loans to small businesses which resulted in most of the monies being routed back to corporations controlled by Wosepka or to his own private use.

Based upon these alleged transactions, a federal grand jury returned a thirty-two count indictment against Wosepka. Counts I through V each charged Wosepka with a separate mailing in execution of a scheme and artifice to defraud the SBA in violation of 18 U.S.C. § 1341 & § 2. (These included Wosepka's letter to the SBA of March 23, 1979 and its enclosed balance sheet and bank's verification letter (Count I) and the four form applications submitted to the SBA by Wosepka for leverage funds (Counts II through V)). Counts VI through IX charged Wosepka with causing four separate wirings of funds from the SBA totaling $1.95 million in violation of 18 U.S.C. § 1343 & § 2. Count X charged Wosepka with making a material false statement to the SBA in violation of 18 U.S.C. § 1001 when he represented that an increase in the private capital of the Company had been made by him. Counts XI through XXVIII charged Wosepka with misapplying the funds of Trans-Am in violation of **18** U.S.C. § **657** by making a series of sham loans which resulted in the return of a substantial portion of the funds to Wosepka and his designees. Counts XXIX through XXXII were dismissed by the district court on the government's motion after Wosepka's motion for their severance had been granted.

Wosepka pled not guilty to all counts of the indictment. During the course of a twelve-day trial, the government called thirty-eight witnesses and introduced approximately five hundred exhibits. Both Wosepka and the government submitted proposed "reasonable-doubt" instructions to the district court. The court declined to use either instruction and, over Wosepka's objection, gave no definition of reasonable doubt other than stating:

> Reasonable doubt, as the name implies, is a doubt based on reason and common sense.

The jury then returned guilty verdicts on all counts.

II.

Wosepka contends that, under the circumstances of this case, the district court's abbreviated reasonable-doubt instruction did not provide the jury with a sufficient basis to determine guilt or innocence and thus constitutes reversible error. Due to the complexity of the case and the conflicting evidence, we agree.

[1] "[A] society that values the good name and

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freedom of every individual should not condemn a man for commission of a crime when there is reasonable doubt about his guilt." In re Winship, 397 U.S. 358, 363-64, 90 S.Ct. 1068, 1072, 25 L.Ed.2d 368 (1970). The reasonable-doubt standard is thus indispensable in our American scheme of criminal procedure. Id. at 364, 90 S.Ct. at 1072. It reduces "the risk of convictions resting on factual error" and "provides concrete substance for the presumption of innocence" which " 'lies at the foundation of the administration of our criminal law.' " Id. at 363, 90 S.Ct. at 1072 (quoting Coffin v. United States, 156 U.S. 432, 453, 15 S.Ct. 394, 402, 39 L.Ed. 481 (1895)). Thus, if in reviewing the district court's reasonable-doubt charge we find that the charge taken as a whole does not fairly and accurately convey the meaning of a reasonable doubt, we must reverse. See Holland v. United States, 348 U.S. 121, 140, 75 S.Ct. 127, 137, 99 L.Ed. 150 (1954); United States v. Newport, 747 F.2d 1307, 1308 (9th Cir.1984).

The skeletal instruction on reasonable doubt given by the court in this case did not fairly or accurately convey the meaning of a reasonable doubt. Although the court ***1009** noted the government's burden to prove guilt beyond a reasonable doubt several times during the instructions, it failed to provide any meaningful explanation of the reasonable-doubt concept. The instructions submitted by both the government and Wosepka gave fuller treatments to the concept of reasonable doubt than that given by the court. The government's requested instruction explained, among other matters, that reasonable doubt is such a doubt as "would cause a reasonable person to hesitate or pause in the graver or more important transactions of life" and "is such a doubt as would cause a juror, after careful and candid and impartial consideration of all the evidence, to be so undecided that he cannot say that he has an abiding conviction of the defendant's guilt." Wosepka's proposed instruction explained that reasonable doubt is "the kind of doubt that would make a reasonable person hesitate to act" and that proof beyond a reasonable doubt must "be proof of such a convincing character that a reasonable person would not hesitate to rely and act upon it in the most important of his own affairs."

[2] The court, however, rejected both these instructions and gave its own shortened version. The court merely stated that reasonable doubt "is a doubt based on reason and common sense." The court, for no apparent reason, deleted critical language defining reasonable doubt in terms of a "hesitation to act" and requiring the jurors to decide the question of guilt or innocence with the same degree of care and attention they would bring to bear "in the most important of their own personal affairs." Given the complexity of this case, the court's abbreviated instruction failed to provide the jury with any meaningful principles or standards to guide it in evaluating the sufficiency of the government's evidence.

We do not find United States v. Witt, 648 F.2d 608 (9th Cir. 1981), to the contrary. Witt found that the trial judge's failure to provide a definition of reasonable doubt was not reversible error. It also noted that " 'an omission or an incomplete instruction is less likely to be prejudicial than a misstatement of the law.' " Witt, 648 F.2d at 610 (quoting Henderson v. Kibbe, 431 U.S. 145, 155, 97 S.Ct. 1730, 1737, 52 L.Ed.2d 203 (1977)). Wosepka involves an instruction which did not fairly or accurately convey the meaning of a reasonable doubt--an instruction Witt recognized as a potential ground for reversal. Furthermore, Witt does not authorize the elimination of explanatory reasonable-doubt instructions in all cases. The issues to be resolved by the jury in that case were fairly straightforward and the evidence was not complex. See 648 F.2d at 611. The Witt court clearly recognized this and limited its holding to the unique circumstances in that case. See 648 F.2d at 610-11 ("We hold that in this case the district court was not required to define reasonable doubt" and that a complete instruction as to the presumption of innocence was not required "under the circumstances of this case.") (emphasis added).

In contrast, the issues raised and the evidence presented in the present case concern disputed transactions. Such transactions, compounded by the vast amount of evidence presented, made it difficult to determine whether the requisite elements could be found beyond a reasonable doubt with respect to each offense. Indeed, the government called thirty-eight witnesses and introduced approximately five hundred exhibits during the twelve-day trial. The testimony of the FBI agent called by the government as a summary witness at the conclusion of its case-in-chief alone fills one hundred and forty-seven

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 128

pages of trial transcript.

[3] Furthermore, the inadequacy of the reasonable doubt instruction is clearly demonstrated by the jury's conviction of Wosepka on Counts II through V of the mail fraud counts. To establish an offense of mail fraud under 18 U.S.C. § 1341, in addition to a scheme to defraud, the government must prove beyond a reasonable doubt that Wosepka caused a use of the United States mails to execute the scheme. United States v. Beecroft, 608 F.2d 753, 757 (9th Cir.1979). With respect to the four applications for leverage funds submitted by Trans-Am to the SBA (which constitute the mailings charged in Counts II through V), the government presented no evidence of the use of the mails other than: (1) the conclusory "yes" of the SBA representative who processed the applications four years prior to trial in response to the prosecutor's questions of whether he had received the applications through the ***1010** mail; and (2) certain exhibits (two of which are applications for leverage funds which are the subjects of Counts IV and V) bearing SBA date and mail room stamps. The defendant introduced into evidence the cover letter accompanying the application that constitutes the mailing charged in Count II expressly stating that such application was delivered "via Federal Express." No evidence was presented by the government to show that Federal Express deliveries were not received and stamped in the SBA mail room. Because a use of Federal Express would not constitute a use of the United States mails, under these circumstances, given a proper reasonable-doubt instruction, a reasonable juror could have had a reasonable doubt with respect to the use of the mails. United States v. Clevenger, 733 F.2d 1356, 1358 (9th Cir.1984) (quoting Jackson v. Virginia, 443 U.S. 307, 319, 99 S.Ct. 2781, 2789, 61 L.Ed.2d 560 (1979)). Cf. United States v. Stull, 521 F.2d 687, 690 (6th Cir.1975), cert. denied, 423 U.S. 1059, 96 S.Ct. 794, 46 L.Ed.2d 649 (1976) (testimony of print shop owner that he received defendant's work orders through the mail four years prior to trial constituted "no more than a conclusion" and was insufficient to sustain conviction in light of other evidence presented). Considering Wosepka's evidence and the government's scarcity of proof, a fuller description of reasonable doubt was clearly necessary to guide the jury in its determination of whether the necessary elements for conviction were present.

III.

Given the circumstances of this case, the district court did not give a sufficient instruction on reasonable doubt. Even the government submitted a proposed reasonable doubt instruction much fuller and more detailed than that given by the court. The court's abbreviated instruction did not provide the guidance the jury needed in this complicated case.

"It was the duty of the court to safeguard the [defendant's] rights, a duty only it could have performed reliably." Taylor v. Kentucky, 436 U.S. 478, 489, 98 S.Ct. 1930, 1936, 56 L.Ed.2d 468 (1978). The skeletal reasonable-doubt instruction given by the district court was not sufficient to protect the defendant from erroneous conviction. See In re Winship, 397 U.S. 358, 363, 90 S.Ct. 1068, 1072, 25 L.Ed.2d 368 (1970).

We therefore REVERSE and REMAND for retrial.

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Single v multiple conspiracy - false entries to defraud SBA. Temporary investments in SBIC to falsely boost capitalization.

UNITED STATES of America, Plaintiff-Appellee,
v.
Glenn W. McMURRAY and R. Glade Whiting, Defendants-Appellants.

Nos. 78-1928, 78-1929.

United States Court of Appeals, Tenth Circuit.

Feb. 10, 1981.

Defendants were convicted in the United States District Court for the District of Utah, Central Division, William G. Juergens, J., of substantive and conspiratorial offenses in violation of the Small Business Investment Act, and they appealed. The Court of Appeals, William E. Doyle, Circuit Judge, 656 F.2d 540, affirmed, and rehearing en banc was sought. The Court of Appeals, Seth, Chief Judge, held, on rehearing, that where money was assembled in segments with different groups providing funds for sole purpose of supporting Small Business Administration applications for guaranty, there was but one conspiracy and thus Government was precluded from retrying defendants on conspiracy charges in view of previous conspiracy prosecutions and fact that members of two groups of "spoke" defendants were not found to have any connection did not mean that there were two separate conspiracies.

Reversed and remanded with directions.

William E. Doyle, Circuit Judge, dissented with opinion in which McWilliams and Barrett, Circuit Judges, concurred.

DOUBLE JEOPARDY ⇐ 151(2)
135Hk151(2)
Formerly 110k202(1)
Where money was assembled in segments with different groups providing funds for sole purpose of supporting Small Business Administration applications for guaranty, there was but one conspiracy and government was precluded from retrying defendants on conspiracy charges in view of previous conspiracy prosecutions and fact that members of two groups of "spoke" defendants were not found to have any connection did not mean that there were two separate conspiracies. **18** U.S.C.A. §§ 2, **1006**; Small Business Investment Act of 1958, § 303, 15 U.S.C.A. § 683.

***696** Keith Biesinger, Salt Lake City, Utah, for defendant-appellant Glenn W. McMurray.

Michael A. Neider, of Watkins & Faber, Salt Lake City, Utah, for defendant-appellant R. Glade Whiting.

William C. Hendricks, III, Atty., U. S. Dept. of Justice, Washington, D. C., for plaintiff-appellee.

Before SETH, Chief Judge, and HOLLOWAY, McWILLIAMS, BARRETT, DOYLE, McKAY, LOGAN and SEYMOUR, Circuit Judges.

On Rehearing En Banc

SETH, Chief Judge.

These are appeals from the District of Utah in number CR-77-11 wherein the appellants were convicted in a jury trial. The appellants McMurray and Whiting urge that errors were committed by the trial court in its denial of their motions for acquittal, and as to certain instructions. They also urge that there was not sufficient evidence to support the verdicts.

Appellants McMurray and Whiting assert that the trial court was in error in its denial of their motions to dismiss on the ground of double jeopardy. The cases were based on several indictments all relating to a Small Business Investment Company.

The grand jury handed down several indictments based on applications made by the Utah Capital Corporation, which was a Small Business Investment Company, to the Small Business Administration. Each indictment in identical language alleges a conspiracy to make false entries in reports and statements in violation of **18** U.S.C. ss **1006** and 2 to defraud the United States by frustrating the operation of the Small Business Administration. Substantive counts were also included in each.

Utah Capital was under the supervision of the Small Business Administration and was in the business of lending funds to small concerns. Under the statute (15 U.S.C. s 683) it could apply to the SBA to issue government guaranteed debentures.

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The amount of such debentures which could be issued by Utah Capital depended on the total of its paid-in capital and surplus. For authorization to issue debentures, Utah Capital had to apply and did apply to the SBA by an Application for Guaranty. In this application it was required to state the amount of its paid-in capital and surplus.

The Government in the indictments alleged that the defendants conspired to falsely and fictitiously misrepresent the amount of Utah Capital's capital and surplus. This was alleged to have been done by making deposits in the corporate bank account of funds which in fact were not unencumbered corporate funds but were provided by a number of persons for temporary use to increase the corporate bank deposits to support an application to issue guaranteed debentures. These advances were by prearrangement returned to the individuals within a very short time. The ***697** application to the SBA was submitted at the time when the bank account of Utah Capital was so fictitiously increased.

The defendant McMurray was president and defendant Whiting was vice president of Utah Capital. Defendant Cassity was the attorney for the corporation. The record shows that the purpose of the conspiracy was to assemble funds in a certain agreed amount, deposit them in a bank, prepare and file the application with the SBA based on the then balance in the account, then return the funds to the individuals who had provided them for the described purpose.

The four indictments each named defendants McMurray, Whiting, and Cassity who came to be known as the "hub defendants." In each indictment there were named other defendants who it was asserted had conspired to provide one of the four segments of the total deposit. These "spoke" defendants were eight in number and were each named in but one indictment. For example, in the indictment which became case number CR-76-126, and was the first tried, defendants McMurray, Whiting, and Cassity were named with the "spoke" defendants Lindquist, Nemelka, and Solomon. It was there alleged that this group had provided $550,000.00 of the $2,185,000.00 deposit on May 21st for use in a SBA application. In CR-77-11 (the case before us) defendant Wilstead was named with McMurray, Whiting, and Cassity in providing $725,000.00, part of which was used in the same May 21st deposit of $2,185,000.00 and part used in a September deposit. The indictments in 76-126 and 77-11 both concern the same deposit to provide apparent support for the same SBA application.

In trial court case number CR-76-126 there were tried defendants McMurray, Whiting, and Cassity, the so-called "hub" defendants, as mentioned above, and others. In CR-76-126 Count I alleged a conspiracy and Counts II through V alleged false entries and aiding and abetting. After jeopardy had attached during the trial in 76-126 the court on the Government's motion dismissed all counts except the conspiracy count.

The jury in CR-76-126 acquitted defendant Cassity but convicted defendants McMurray, Whiting, and Nemelka. The convictions were appealed and became in this court 79-1655, 79-1654, and 79-1393. The cases were consolidated and the panel opinion was filed November 13, 1980.

The defendant Cassity who was acquitted in CR-76-126 was brought to trial under another of the four indictments in case CR-77-13. On motion of Cassity the trial court dismissed on the ground of double jeopardy arising from the trial in 76-126. We affirmed the dismissal on the Government's appeal in our 79-1077 with an opinion filed January 31, 1980.

The Government also sought to again try defendants McMurray and Whiting, who had been convicted in 76-126 on another of the four indictments as case number CR-77-11. Defendant Wilstead was tried in CR-77-11. He had not been tried before. The trial judge, who did not hear 77-13 (Cassity), denied the double jeopardy motions of defendants McMurray and Whiting and they went to trial. This denial, and the subsequent convictions, were appealed to this court and became numbers 78-1928, 78-1929, and 78-1930. The panel filed an opinion on March 5, 1980. 656 F.2d 540. Rehearing en banc was granted and this is the opinion on such rehearing.

We must hold that there was but one conspiracy and this was to amass the $2,185,000.00 for deposit to support the SBA application. It was assembled in segments with different groups providing funds for the purpose of supporting the Application for Guaranty. This was the objective of all the

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arrangements.

The Government asserts that there was no connection directly between the two "spoke" groups here concerned (CR-76-126 and CR-77-11), and thus each acted independently with the "hub" group. The Government thus takes the view that each arrangement with a "spoke" group for a segment of the total deposit was a separate conspiracy. It thus moves back one step from the assembly of, and the making of ***698** the total deposit, and moves back from the submission of the application.

We are persuaded by the singleness of the ultimate objective of all the defendants. It was a narrow one and was to make the deposit to support the application to the SBA. It took a lot of arranging, some close timing, and a number of individuals to accomplish the objective, but again it was but one well defined objective. With each of the two "spoke" groups the subsidiary objective was to arrange for one segment or portion of the total deposit. The "spoke" group in CR-76-126 had no direct relationship with the group in CR-77-11; each was negotiated with separately by the "hub" group directly. All planning was directed by the "hub" defendants to the ultimate deposit and application.

In examining the scope of the conspiracy, we must look to the submission of the Application for Guaranty as the most important element. This submission was the basic aim of all the arrangements. The dollar total therein or in the supporting deposit is not significant for our purposes, but the submission was. It is apparent that all the convicted conspirators in CR-76-126 and CR- 77-11 entered into the sham investment plan to support an Application for Guaranty. The success of the application influenced the "spoke" defendants' compensation or that of most of them. The indictment alleged that the "spoke" defendants would receive loans for their participation. It is thus apparent that all the defendants in both cases were concerned with the success of the application, and the whole arrangement was dependent thereon.

The proof did not show that the "spoke" defendants had any contact or connection with other "spoke" defendants. Obviously the "hub" defendants were the same. Thus as the record before us stands, there is no showing of any connection or meetings between the two groups of "spoke" defendants.

Under the authorities it is not necessary that each conspirator agree with all others or even know of the others, or have contact with each of them. Blumenthal v. United States, 332 U.S. 539, 68 S.Ct. 248, 92 S.Ct. 154, presents fundamental issues as to the admission of evidence and its impact on the various defendants. However, on the broader questions the Court stated that participants could be convicted upon a showing of the nature of the plan and their connections with it, and "without requiring evidence of knowledge of all its details or of the participation of others." The Court continued to demonstrate several details in the conspiracy which might be unknown to some of the conspirators. This included knowledge of the participation by the unknown owner of the whiskey in the arrangement. The Court also there stated:

> "By their separate agreements, if such they were, they became parties to the larger common plan, joined together by their knowledge of its essential features and broad scope, though not of its exact limits, and by their common single goal."

And further:

> "All by reason of their knowledge of the plan's general scope, if not its exact limits, sought a common end, to aid in disposing of the whiskey. True, each salesman aided in selling only his part. But he knew the lot to be sold was larger and thus that he was aiding in a larger plan. He thus became a party to it and not merely to the integrating agreement with Weiss and Goldsmith."

In Kotteakos v. United States, 328 U.S. 750, 66 S.Ct. 1239, 90 L.Ed. 1557, each loan was a separate transaction complete in itself each with a separate illegal purpose and end. The only connection shown was that Brown handled all the loan applications. Each was a direct transaction, and was not part of a chain of events common in drug conspiracies.

We must again refer to the single purpose of the arrangement for the temporary use of the "spoke" defendants' funds. The defendants in both cases knew of this purpose; this was the plan and the agreement. Again, it was not necessary for all to know the ultimate dollar figure. It was not necessary that all know the others involved in the same purpose-those who provided other ***699** dollars. The "hub" defendants dealt separately with

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the groups in the accumulation of the funds, but all was for the same purpose and the separate dealings did not thereby create separate conspiracies. Nor could the Government by separate indictments divide up a single conspiracy. Thus we must hold that but one conspiracy has been shown to exist, and the defense of double jeopardy was valid.

It is apparent that the issue as to whether one or more conspiracies existed in the cases before us is to be resolved by an examination of the facts. The problem is a factual one and each case is unique. There are no general legal propositions which will decide all the cases; instead, an examination must be made on a case by case basis starting with the purpose of the conspiracy and how it was carried out. The agreement obviously is the central element of any conspiracy. The agreement includes the objective of the combination. The objective here was to defraud the SBA by the Application for Guaranty based on fictitious bank deposits. All the convicted defendants knew the objective-the purpose of the accumulation of funds, and all participated in attaining the objective. In the cases before us there were two groups seeking to accomplish the same ends. The several participants had somewhat different roles as we have described. The success of the agreement was to be the approval of the application, and all worked to this end. The facts before us with the clear objective-a single business transaction-which all participants were seeking to bring about present a very much clearer picture than do the many drug conspiracies which find their way to the courts. See, for example, our United States v. Martinez, 562 F.2d 633 (10th Cir.). We have here a limited time span with the same cast of characters throughout. The comparison must again be made with the facts in Blumenthal v. United States, 332 U.S. 539, 68 S.Ct. 248, 92 S.Ct. 154, from which we have taken quotations in the preceding paragraphs. This was a conspiracy to sell whiskey provided by an unidentified owner which had come into the possession of Weiss and Goldsmith. The issue was whether there was one conspiracy to dispose of the whiskey or whether there were two conspiracies, one between Weiss-Goldsmith and the owner and another between Weiss-Goldsmith and the several salesmen. The Court decided there was one conspiracy and said:

> "All knew of and joined in the overriding scheme. All intended to aid the owner, whether Francisco or another, to sell the whiskey unlawfully, though the two groups of defendants differed on the proof in knowledge and belief concerning the owner's identity. All by reason of their knowledge of the plan's general scope, if not its exact limits, sought a common end, to aid in disposing of the whiskey. True, each salesman aided in selling only his part. But he knew the lot to be sold was larger and thus that he was aiding in a larger plan. He thus became a party to it and not merely to the integrating agreement with Weiss and Goldsmith."

The defendants here all knew of the general plan, purpose, and aim, as we have mentioned. All were aware of the accumulation of funds for the May deposit and the purpose of the deposit. Some participated by providing different amounts of money as compared to the sales in Blumenthal of different quantities of whiskey. The knowledge, the awareness of the purpose and objective are the same in this case as in Blumenthal.

The judgments of conviction of defendant Glenn W. McMurray in CR-77-11 Utah (our number 78-1928) and of R. Glade Whiting in CR-77-11 Utah (our number 78-1929) are reversed and the cases remanded with directions to dismiss the actions and the indictments.

DOYLE, Judge, dissenting.

I respectfully dissent.

The problem is whether a prior adjudication forms a basis for claiming former jeopardy. The ultimate question is whether the several indictments involved one conspiracy or four, and so the cause has to be determined ***700** in relationship to the surrounding facts, with a view to deciding whether the indictments which are here being considered have an independent identity, or whether they are all part of a single conspiracy. The authorities, and particularly the decisions of the United States Supreme Court, must be examined and the standards and tests which are contained in those cases are to be applied to the solution.

I have no quarrel with the facts which are set forth in the majority opinion. I do feel, however, that some supplemental statement must be given for the purpose of showing the case in a light which shows my approach to the case.

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On February 8, 1977, in the United States District Court for the District of Utah, an indictment was returned against Glenn W. McMurray, R. Glade Whiting, Donn E. Cassity and Robert H. Wilstead. This indictment alleged that the Small Business Administration, a United States agency charged with the administering of the Small Business Investment Act of 1958, was defrauded by the defendants. Appellants McMurray and Wilstead were convicted following a trial to a jury. Cassity was dismissed out. They were found guilty on a conspiracy count and on additional substantive counts which charged false entries in books and accounts. Two of the several substantive counts were dismissed during the trial.

McMurray and Whiting are referred to throughout the case as "hub" defendants. Wilstead, on the other hand, for the purposes of the conspiracy, is referred to as a so-called "spoke" defendant. The appeal by McMurray and Whiting pertains to their contention that the conspiracy is barred by the Fifth Amendment doctrine of former jeopardy. Various other errors are set forth in the briefs, but there is no necessity for treating these contentions here.

The instrument for carrying out the fraud was Utah Capital Corporation, which was a small business investment company organized by the hub defendants, and licensed by the SBA pursuant to 15 U.S.C. Sec. 681. McMurray was the President and Chairman of the Board of Directors of UCC, and Cassity was Legal Counsel; R. Glade Whiting was the Vice-President and Director.

The Small Business Administration sought to make private funds available to small businesses. At the same time it sought to insure the private financial interests of the owners of small business investment companies such as UCC. To achieve these purposes it guaranteed payments on debentures issued by the Small Business Administration, subject to the restriction that the total amount of debentures guaranteed at any time from an **SBIC** was not to exceed 200% of the combined private paid-in capital and paid-in surplus of the company. This feature is the key to the fraud that was perpetrated. Because of it the defendants sought to build up their apparent paid-in capital and surplus in order to be able to issue a greater amount of securities debentures. Following the grand jury investigation four indictments were returned, charging a total of eleven defendants. Three of these, McMurray, Whiting and Cassity, were charged in each of the four indictments, although they have not been prosecuted on all indictments. Wilstead and the other defendants, all of whom have been referred to as spoke participants in the conspiracy cases, were charged in one indictment each.

The several indictments described distinct transactions, so I contend; conspiracies to defraud the government and substantive offenses involving independent false entries in the books and records of the Utah Capital Corporation. McMurray and Whiting were charged in each of the indictments. They were the operators of UCC, and were the ones who apparently conceived the scheme. Wilstead participated only in this one transaction and had nothing to do with the prior transaction which occurred four months or so before. In this case his role was loaning the added funds to swell the paid-in capital.

Although its mechanics were the same, the amounts of money utilized and the other cover-up facts were generally distinct. ***701** The Small Business Administration was defrauded distinctly and independently in all four transactions; each group was charged with the making and receipt of a distinct sham investment in UCC. The investment was a substantial amount of money and was not retained by UCC. It was immediately returned to the contributing defendants by way of alleged sham loans to fictitious business entities. In truth these purported loans constituted the return of moneys that had been loaned for just long enough to mislead the Small Business Administration as to the amount of paid-in capital that the corporation had. There were false entries made in the books in order to support the fraud.

UCC qualified for matching funds guaranteed by the Small Business Administration, and upon its receipt of these guarantees each of the four capital providing groups was provided with accommodation loans as consideration for their previous participation. Wilstead was no exception.

The defendants McMurray and Whiting were charged with serving as a hub in arranging sham investments by various spoke defendants. There is no showing that one group of spoke defendants was familiar with the fact that there were other

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transactions and other spoke participants.

In CR-76-126, United States District Court for the District of Utah, which charge is held to bar the offense here, the hub defendants and principals of UCC were charged with conspiracy to fictitiously increase UCC's paid-in capital and surplus in the amount of $550,000. The funds were raised by other defendants who were in no way involved here. They were Lindquist, Nemelka and Solomon, and the funds were reflected on UCC's books as an investment by Robert Solomon. Shortly after its receipt, the $550,000 became part of a larger $2,185,000 bank deposit, on May 21, 1973, which deposit was shown in UCC's application for guarantee submitted to the SBA on May 21, 1973. The $550,000 was withdrawn from UCC's bank account within a very short time after it was deposited. Thereafter the funds were returned to Solomon and Lindquist, according to plan, through a series of bogus loans made to sham corporations controlled by Solomon, Lindquist and Nemelka. In return for this circular capitalization process, defendants Solomon, Lindquist and Nemelka received other loans from UCC. This was to compensate them for the momentary use of the $750,000.

The transaction that is here being considered, which is the subject of the indictment, occurred some months later, September, 1973. This was CR-77-11 in the United States District Court for the District of Utah, with the same hub defendants and principals, being McMurray, Whiting and Cassity, with Wilstead being the spoke defendant and financier. They were alleged to have entered into a separate agreement to fictitiously increase UCC's paid-in capital surplus by $725,000. As a result of this agreement, $200,000 became part of the May 21, 1973 bank deposit, and $525,000 became part of a second application, made in September of 1973. These funds were almost immediately withdrawn from UCC's control and returned to defendant Wilstead, the spoke defendant, through the use of sham loans to corporations controlled by him. Thereafter Wilstead received other pay-off loans from UCC to compensate him for the temporary use of the $725,000.

Similar schemes were alleged to have occurred in CR-77-13, with defendants West and Jolly participating, and CR-77-16, with defendants Rigby and Lord participating. Both of these indictments were dismissed as to McMurray and Whiting. There was a degree of co-mingling of other funds in the September transaction which is CR-77-11 in the district court. In CR-76-126 the amount co-mingled on May 21, 1973 constituted 100% of the sham capitalization employed in the alleged conspiracy. In CR-77-11, however, the amount co-mingled on May 21, 1973, constituted only 20%, $200,000, of the total $725,000. This is attributable to the fact that the sham capitalization in CR-77-11 agreement continued up to the September, 1973 UCC application, whereas CR-76-126 had nothing to do with this later period.

***702** In June of 1978, CR-76-126, was tried to a jury before Chief Judge Fred M. Winner of the Colorado United States District Court. During the trial, on the government's motion, the court dismissed all counts of the indictment except the count of conspiracy. The jury returned verdicts of acquittal as to Cassity and guilt as to defendants McMurray and Whiting, and this is the basis for the present contention that former jeopardy precludes subsequent prosecution in the September transaction, which is the conviction which is being reviewed here.

The present case was tried to a jury in August of 1978, with the Honorable John Jurgens presiding. The jury returned verdicts of guilty as to conspiracy and as to Counts II, III, IV and VII, involving false entries and aiding and abetting, as to appellants McMurray, Whiting and Wilstead. Counts V and VI were dismissed on motion of the government. McMurray and Whiting, after entry of the judgments, moved the court for judgments of acquittal because of former jeopardy. These motions were denied, and they are now appealed.

The basic contention of the appellants is that the allegations of the various indictments are substantially identical and this called for treating the several incidents as a single conspiracy. Under their characterizations of the facts, there is only one agreement and objective, namely to obtain for UCC guaranteed debentures by allegedly increasing UCC's paid-in capital in connection with UCC's May, 1973, application for a guarantee. Since McMurray and Whiting were tried and convicted for this, they claim it is double jeopardy to convict them for the conspiracy which was established in the

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present case.

The government's position is, of course, that the four original indictments each charge a separate and independent agreement. Although each agreement contemplated violation of the same statute, they were separate transactions and not part of a single grand jury scheme. Therefore, the government contends that conviction for the conspiracy charged in the separate cases does not constitute double jeopardy, and that is what this dissent is all about.

We now address the question whether the several frauds are a part of one single conspiracy or are to be regarded as independent transactions, because the result reached depends upon this analysis.

The mere fact that the same hub defendants are charged with being members of the two conspiracies and that both concerned transactions with the same subject matter and overlapped in time does not establish that they are the same for double jeopardy purposes. See United States v. Martinez, 562 F.2d 633 (10th Cir. 1977). The Government's argument, which to this writer is valid, is that although various different parties conspire with one common hub group of conspirators, the evidence may nevertheless show that separate conspiracies were involved, and that no one combination embraced the objectives of the others. United States v. Martinez; United States v. Butler, 494 F.2d 1246, 1255 (10th Cir. 1974); Kotteakos v. United States, 328 U.S. 750, 66 S.Ct. 1239, 90 L.Ed. 1557 (1945).

The scope of the agreement to do unlawful acts and the scope of the conspiracy gives the answer to our question. If the evidence reveals a single over-all agreement to carry out an illegal plan or goal, then a single conspiracy may very well exist. A single plan, however, requires more dependence between the participants, and general knowledge of the spoke defendants as to the scope of the scheme or plan. Thus, this is not like a conspiracy to possess and distribute heroin and to sell it to various people. This may very likely be one conspiracy while it lasts, and in each instance the sellers that "retail" know full well of the general conspiracy and that their particular sales serve that conspiracy. If the numerous defendants participating in a conspiracy are to be brought into the fundamental scheme it is necessary that there be facts present to justify bringing all of the conspirators within the single agreement. And it would have to appear also that all of the objectives were contemplated in the one conspiracy.

***703** The Supreme Court has spoken on this in positive terms in the case of Kotteakos v. United States, supra, which has facts which are similar to those before the court. The issue there was whether the petitioner suffered substantial prejudice from being convicted of a single general conspiracy by evidence which, as admitted by the government, proved to be not one conspiracy, but several of the same type and having the same subject matter, and did so through a common figure, as here. In Kotteakos the indictment alleged that one Brown was the central figure (the hub defendant) in a scheme to induce various financial institutions to grant credit with the intent that the loans or advancements would then be offered to the Federal Housing Administration for insurance upon applications containing false and fraudulent information. Brown pleaded guilty. He had acted as a broker for others in placing the loans, and charged five percent commission for his services. Brown obtained loans for several persons and groups of persons named in the original conspiracy indictment. The Supreme Court concluded:

> The evidence against the other defendants whose cases were submitted to the jury was similar in character. They too had transacted business with Brown relating to National Housing Act loans. But no connection was shown between them and petitioners, other than that Brown had been the instrument in each instance for obtaining the loans. In many cases the other defendants did not have any relationship with one another, other than Brown's connection with each transaction. As the Circuit Court of Appeals said, there were "at least eight, and perhaps more, separate and independent groups, none of which had any connection with any other, though all dealt independently with Brown as their agent." (United States v. Lekacos,) 151 F.2d (170) at 172 ((2nd Cir.)). As the Government puts it, the pattern was "that of separate spokes meeting in a common center," though, we may add, without the rim of the wheel to enclose the spokes.

The Supreme Court further said (328 U.S. at 768, 66 S.Ct. at 1249):

> The trial court was of the view that one conspiracy was made out by showing that each defendant was

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linked to Brown in one or more transactions, and that it was possible on the evidence for the jury to conclude that all were in a common adventure because of this fact and the similarity of the purpose presented in the various applications for the loans.
This view, specifically embodied throughout the instructions, obviously confuses the common purpose of a single enterprise with the several, though similar, purposes of numerous, separate adventures of like character.

The Supreme Court concluded that the petitioners before it had suffered substantial prejudice by being convicted of a single general conspiracy on evidence which the government admitted proved not one conspiracy, but some eight or more. The ruling was believed necessary in order to protect each defendant's right to have guilt determined on an individual basis, and thereby to avoid the dangers of transference of guilt from one defendant to another across lines separating conspiracies. We submit that if a single conspiracy for the four transactions had been here charged, and the trial had been on that theory, the defendants would be here protesting that they were being prejudiced by several conspiracies; that they were convicted of one conspiracy when, in truth, there were several, and they were thereby prejudiced. Therefore, the government is placed in a situation in which there will be protests regardless of how it proceeds.

Another Supreme Court decision which deals with this general problem is Blumenthal v. United States, 332 U.S. 539, 68 S.Ct. 248, 92 S.Ct. 154 (1947). There, four petitioners and another defendant were convicted of conspiring to sell whiskey at prices above the ceiling set by regulations of the Price Administration, in violation of the Emergency Price Control Act. The evidence showed that each of the defendants had a part in arranging sales and deliveries of portions of two larger shipments of liquor ***704** to purchasers. The defendants were intermediaries between an unknown owner of the liquor and the tavernkeepers. The indictments alleged a single conspiracy. The issue considered by the Supreme Court was whether the evidence established that there was more than one conspiracy.

It is of interest to note that the defendants in the Blumenthal case who were intermediaries between an unknown owner of the liquor and the tavernkeepers were alleged to have acted pursuant to a single conspiracy. The issue addressed by the Supreme Court was whether the evidence established multiple conspiracies, and thus ran counter to Kotteakos.

The ruling of the court stemmed from the concept that the five defendants joined in a single conspiracy to sell whiskey at excessive prices and did so in the guise of legal sales, and the agreements involved were merely steps in the formation of the larger and ultimately general scheme. The court said the scheme was, in fact, the same one. The court added that the determining factor was that the salesmen knew, or must have known, that others unknown to them were sharing in so large a project. The court said further that by their separate agreements, if such they were, they became parties to the larger common plan, joined together by their knowledge of its essential features and broad scope, even though they did not know its exact limits. Blumenthal differed from the Kotteakos case in that in the latter each loan was an end in itself, separate from others, although were alike in having similar illegal objects. With the exception of Brown, the common figure, no conspirator was interested in whether any loan, except his own, went through, and no one aided in any way, by agreement or otherwise, in procuring another's loan. The court concluded:

The conspiracies, therefore, were distinct and disconnected, not part of the larger general scheme, both in the phase with Brown and in the absence of any aid given to any others, as well as in specific object and result.

The court also said there was no drawing of all (participants) together in a single, over-all comprehensive plan.

It is to be concluded from reading the above two decisions that the distinguishing feature in this type of case is some knowledge on the part of the spoke participants as to the general scope of the alleged goals of the general conspiracy. One cannot be said to agree to join a conspiracy to achieve illegal objectives without general knowledge of the scope of a larger plan and what is involved in the plan. Thus, there must be interdependence among the conspirators in reaching the ultimate objective of the conspiracy, and this serves as a basis for imputing knowledge of the larger plan to peripheral participants and ties all of them together in one scheme.

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But in the case before us there is a complete lack of evidence as to the knowledge of the spoke defendants of the other transactions. None of the defendants charged with putting up the money, which was the main feature in the conspiracy in four separate indictments, had any knowledge that McMurray and Whiting were engaged in any similar transactions involving the money of other people, which transactions also misled the Small Business Administration. The separate transactions appear to have proceeded independently and to have had, as well, an independent character and identity. The success or failure of each transaction was not dependent upon the success or failure of the others.

The facts of the case here are very close to those in Kotteakos, where a core group of individuals was involved in distinct transactions with a variety of unrelated other persons.

This court in Bartlett v. United States, 166 F.2d 928 (10th Cir. 1948) considered a fact situation in which the appellants, along with another individual, were convicted under a charge of conspiracy to violate federal laws having to do with the rationing of sugar. They had previously been convicted on a conspiracy charge involving another scheme to manipulate entries of credit in the sugar account. They contended that double jeopardy precluded the second conviction. This court disagreed. It determined that the evidence justified the conclusion that separate agreements were entered into, rather than that there was a ***705** single large conspiracy. The test for determining whether the offenses charged were identical was stated to be whether the facts alleged in one, if offered in support of the other, would sustain a conviction. When one indictment requires proof of a fact which the other indictment does not, the conclusion is that the several offenses charged are not identical for double jeopardy purposes.

The same evidence test is admittedly broader than the test that is discussed by the Supreme Court in Kotteakos and Blumenthal, but it nevertheless has been used to a great extent, even though recently there has been some criticism of it. See United States v. Papa, 533 F.2d 815 (2nd Cir. 1976); cert. denied 429 U.S. 961, 97 S.Ct. 387, 50 L.Ed.2d 329. The criticisms have been made in the course of considering narcotics conspiracies, and in those cases there is potential for prosecutorial splitting of conspiracies, due to the nature of the relationships involved. It would appear that in narcotics cases it has been regarded more logical to proceed on the theory of the conspiracy being one rather than several. In the Papa case the claim of double jeopardy was raised when the defendant was convicted of a charge of conspiring to traffic in narcotics. He claimed the conviction was barred because of a previous conviction on a guilty plea to another indictment which involved conspiracy to traffic in narcotics. The court found that the defendant was the director of two unrelated chains distributing narcotics, and the mere fact that he supervised each did not transform two separate conspiracies into one.

A more recent case in the Second Circuit is United States v. DeFillipo, 590 F.2d 1228 (2d Cir. 1979), cert. denied 442 U.S. 920, 99 S.Ct. 2844, 61 L.Ed.2d 288. The court there recognized that the government was not empowered to prosecute a defendant for conspiracy twice where there is a single agreement, but two crimes. The court rejected, however, the defendant's double jeopardy argument, because it determined that there were two separate distinct conspiracies to commit the same substantive offense, and although it acknowledged that the same evidence test was not necessarily applicable, it considered the relationship to be two transactions. It held that there had been independent agreements involved in each case, rather than one continuing conspiracy.

In summary, the evidence here discloses independent transactions, the use of independent funds in the fraud and the obtaining of an independent result. The spoke defendant Wilstead is not shown to have known of other transactions. The two transactions here being scrutinized occurred at different times with a different financier, and a distinct act of misleading the Small Business Administration.

After all, the ultimate question should be whether the transactions are identical whereby an adjudication of one bars the other. I maintain that the facts show that each of these has its own identity.

I am authorized to state that Circuit Judge McWILLIAMS and Circuit Judge BARRETT concur in the foregoing dissent.

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If SBA had known → approval?

Purpose of loan. (Tucker) CS & W appl.

⇒ proceeds for init operating capital, → funct. equiv. of down payment.
maint & painting of storage tank.

SBIC → financial institution
& Colleton.

§ 1341 –

UNITED STATES of America, Plaintiff-Appellee,
v.
J. Frank HANCOCK, Defendant-Appellant.

No. 28067.

United States Court of Appeals, Fifth Circuit.

April 28, 1971, Rehearing Denied May 27, 1971.

Defendant was convicted before the United States District Court for the Middle District of Florida, Joseph P. Leib, Chief Judge, of embezzling, abstracting, and willfully misapplying small business investment company funds, and he appealed. The Court of Appeals, John R. Brown, Chief Judge, held that evidence on issue whether funds were property of small business investment corporation at time funds were acquired by corporate organizer, who had engineered series of corporate loans entailing direct or circuitous repayments to himself, supported conviction.

Affirmed.

[1] CRIMINAL LAW ⇐ 629(3.1)
110k629(3.1)
Formerly 110k629
Denial of defendant's motions for list of government witnesses and discovery order for purpose of taking their depositions did not violate his rights under the Fifth and Sixth Amendments; but, in any event, defendant was not prejudiced where all of the major witnesses were individuals with whom defendant had had significant personal or financial relations and it did not appear that list would have materially aided him in preparation of defense. U.S.C.A.Const. Amends. 5, 6.

[1] CRIMINAL LAW ⇐ 1166(11)
110k1166(11)
Denial of defendant's motions for list of government witnesses and discovery order for purpose of taking their depositions did not violate his rights under the Fifth and Sixth Amendments; but, in any event, defendant was not prejudiced where all of the major witnesses were individuals with whom defendant had had significant personal or financial relations and it did not appear that list would have materially aided him in preparation of defense. U.S.C.A.Const. Amends. 5, 6.

[2] CRIMINAL LAW ⇐ 629(3.1)
110k629(3.1)
Formerly 110k629
Apart from congressionally created exception in capital cases, granting of defense request for list of adverse witnesses is a matter of judicial discretion, and the denial can be challenged only for abuse. 18 U.S.C.A. § 3432.

[3] CRIMINAL LAW ⇐ 627.5(1)
110k627.5(1)
Discovery in criminal prosecutions is narrower than it is in civil cases.

[4] EMBEZZLEMENT ⇐ 20
146k20
Phrase "small business investment company" as used in statute making it offense to improperly receive or use funds belonging to small business investment company refers only to those businesses licensed under Small Business Investment Act. 18 U.S.C.A. § 657.

See publication Words and Phrases for other judicial constructions and definitions.

[5] CRIMINAL LAW ⇐ 29(3)
110k29(3)
Formerly 110k29
It was for prosecutorial discretion whether to charge small business investment corporation organizer, who engineered series of corporate loans entailing direct or circuitous repayments to himself, either under statute governing fraudulent misapplication of funds or under statute prescribing fraudulent receipt. 18 U.S.C.A. §§ 657, 1006.

[6] EMBEZZLEMENT ⇐ 44(1)
146k44(1)
Evidence on issue whether funds were property of small business investment corporation at time funds were acquired by corporate organizer, who had engineered series of corporate loans entailing direct or circuitous repayments to himself, supported conviction of embezzling, abstracting, and willfully misapplying small business investment company funds. 18 U.S.C.A. § 657.

***1286** Loyd C. Mosley, N. S. Gould, Clearwater, Fla., for defendant-appellant.

John L. Briggs, U.S. Atty., Thomas G. Wilson,

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Special Asst. U.S Atty., Hugh N. Smith, Asst. U.S. Atty., Tampa, Fla., for plaintiff-appellee.

Before JOHN R. BROWN, Chief Judge, and WISDOM and MORGAN, Circuit judges.

JOHN R. BROWN, Chief Judge:

J. Frank Hancock, former president and principal organizer of the Clearwater Capital Corporation, was charged in a nine count indictment with embezzling, abstracting, and willfully misapplying small business investment company funds in violation of 18 U.S.C.A. 657. Following a jury trial he was convicted and sentenced to concurrent five-year terms on all counts. We affirm.

Initially Hancock alleges error of constitutional dimensions by asserting that the Trial Court's denial of his motions for a list of government witnesses and a discovery order for the purpose of taking their depositions violated his rights under the Fifth and Sixth Amendments. We reject this contention. Apart from the Congressionally created exception in capital cases, /1/ the granting of a defense request for a list of adverse witnesses is a matter of judicial discretion, and a denial can be challenged only for abuse. O'Neal v. United States, 5 Cir., 1969, 411 F.2d 131, 138, cert. denied, 396 U.S. 827, 90 S.Ct. 72, 24 L.Ed.2d 77; Downing v. United States, 5 Cir., 1965, 348 F.2d 594, 599, cert. denied, 382 U.S. 901, 86 S.Ct. 235, 15 L.Ed.2d 155. All of the major witnesses were individuals with whom the defendant had had significant personal or financial relations, and it does not appear that the list would have ***1287** materially aided him in the preparation of his defense.

Likewise, with the scope of discovery in criminal prosecutions narrower than it is in civil cases, Campbell v. Eastland, 5 Cir., 1962, 307 F.2d 478, 487, cert. denied, 371 U.S. 955, 83 S.Ct. 502, 9 L.Ed.2d 502, and in the absence of a rule which permits the taking of depositions of witnesses who will appear at the trial of a criminal case, we cannot say at this juncture that such a procedure has yet been elevated to a constitutional plane even though some states have been fit to adopt it.[FN2] It any event the defendant's relationship with the prospective witnesses preculdes a finding that he was prejudiced by the denial of his motion for discovery.

[4] Appellant also asserts that 657 is fatally defective-- presumably on grounds of vagueness-- because it does not explicitly define the phrase 'small business investment company,' and that this omission can be cured only by the indictment's unwarrnated addition of the words 'licensed under the Small Business Investment Act.' Since Title VII of the Small Business Investment Act of 1958[FN3] amended the related criminal provision, we think it clear that the reference in 657 is only to those businesses licensed under the Act, rather than to all small businesses generally. Clearwater Capital Corporation is thus a 'small business investment company' designated by 657.

[5] As for Appellant's argument that he could more appropriately have been charged under 18 U.S.C.A. 1006,[FN4] the obvious answer is that a criminal defendant has no choice in the matter. Prosecutorial decisions of this nature are wholly matters of Executive discretion. United States v. Cox, 5 Cir., 1965, 342 F.2d 167 (en banc), cert. denied sub nom. Cox v. Hauberg, 381 U.S. 935, 85 S.Ct. 1767, 14 L.Ed.2d 700.

[6] Finally Appellant mounts a frontal assault on the sufficiency of the evidence, contending that the funds were not the property of the corporation at the time he acquired them. We think it clear from a careful reading of the record that there was ample evidence from which the jury could have concluded that the defendant had engineered a series of corporate loans entailing direct or circuitous repayments to himself, in which the borrowers-- all personal or business acquaintances-- were mere conduits through which the funds were ultimately rechanneled for his use of benefit, not the least of the benefits being that the equity capital required by the organizers of a small business investment company came from loans made by the company after it was set up. The predictable result of these transactions was that Hancock benefited and Clearwater Capital Corporation went into receivership. The evidence amply supports a finding of misapplication of corporate funds with criminal implications.[FN5]

Affirmed.

FN1. 18 U.S.C.A. 3432.

FN2. Fla.R.Crim.P. 1.220, 33 F.S.A.

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FN3. 'Section 657 of title 18, United States Code, is amended by inserting after 'Federal Savings and Loan Insurance Corporation,' the following: 'or any small business investment company." 72 Stat. 689, 698 (1958).

FN4. Fraudulent misapplication of funds is the essence of 657, while 1006 proscribes fraudulent receipt. United States v. Weaver, 7 Cir., 1966, 360 F.2d 903, 904.

FN5. We need not here belabor the technical and perhaps somewhat illusory distinctions between the terms 'embezzle,' 'abstract,' 'purloin,' and 'willfully misapply,' a problem we considered under the identical provisions of 656 in Williamson v. United States, 5 Cir., 1964, 332 F.2d 123, 133. The Trial Court's instructions incorporated adequate definitions, and we think the jury might properly have concluded that the acts charged fell within any or all of these prohibitions.

END OF DOCUMENT

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§ 19. Petty offense defined

As used in this title, the term "petty offense" means a Class B misdemeanor, a Class C misdemeanor, or an infraction, for which the maximum fine is no greater than the amount set forth for such an offense in section 3571(b)(6) or (7) in the case of an individual or section 3571(c)(6) or (7) in the case of an organization.

(Added Pub.L. 100–185, § 4(a), Dec. 11, 1987, 101 Stat. 1279, and amended Pub.L. 100–690, Title VII, § 7089(a), Nov. 18, 1988, 102 Stat. 4409.)

HISTORICAL AND STATUTORY NOTES

1988 Amendment

Pub.L. 100–690 inserted ", for which the maximum fine is no greater than the amount set forth for such an offense in section 3571(b)(6) or (7) in the case of an individual or section 3571(c)(6) or (7) in the case of an organization" after "infraction".

Legislative History

For legislative history and purpose of Pub.L. 100–185, see 1987 U.S.Code Cong. and Adm. News, p. 2137. See, also, Pub.L. 100–690, 1988 U.S.Code Cong. and Adm.News, p. 5937.

NOTES OF DECISIONS

Sentences 1
Trial by jury 2

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1. Sentences

Petty offense constitutionally can include sentences of up to six months for criminal contempt. In re Betts, C.D.Ill.1990, 730 F.Supp. 942, reversed 927 F.2d 983, on remand 770 F.Supp 457.

2. Trial by jury

To same effect as U.S. v. Kovel, 908 F.2d 205, this note number, see Matter of Betts, C.A.7 (Ill.) 1991, 927 F.2d 983.

Statute defining the term "petty offense" did not create entitlement to jury trial, even in cases of criminal contempt where prison sentence might be imposed; purpose of statute was simply to limit prison time for crimes covered by section to six months, without forbidding it, and to put $5,000 cap on permissible fines. U.S. v. Kozel, C.A.7 (Ill.) 1990, 908 F.2d 205, certiorari denied 111 S.Ct. 969, 498 U.S. 1089, 112 L.Ed.2d 1055.

§ 20. Financial institution defined

As used in this title, the term "financial institution" means—

(1) an insured depository institution (as defined in section 3(c)(2) of the Federal Deposit Insurance Act);

(2) a credit union with accounts insured by the National Credit Union Share Insurance Fund;

(3) a Federal home loan bank or a member, as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422), of the Federal home loan bank system;

(4) a System institution of the Farm Credit System, as defined in section 5.35(3) of the Farm Credit Act of 1971;

(5) a small business investment company, as defined in section 103 of the Small Business Investment Act of 1958 (15 U.S.C. 662);

(6) a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act;

(7) a Federal Reserve bank or a member bank of the Federal Reserve System;

(8) an organization operating under section 25 or section 25(a) of the Federal Reserve Act; or

(9) a branch or agency of a foreign bank (as such terms are defined in paragraphs (1) and (3) of section 1(b) of the International Banking Act of 1978).

(Added Oct. 12, 1984, Pub.L. 98–473, Title II, § 1107(a), 98 Stat. 2145, § 215(c); renumbered § 215(b) and amended Aug. 4, 1986, Pub.L. 99–370, § 2, 100 Stat. 779; renumbered § 20 and amended Aug. 9, 1989, Pub.L. 101–73, Title IX, § 962(e)(1), (2), 103 Stat. 503; Nov. 29, 1990, Pub.L. 101–647, Title XXV, § 2597(a), 104 Stat. 4908.)

HISTORICAL AND STATUTORY NOTES

References in Text

Section 3 of the Federal Deposit Insurance Act, referred to in pars. (1) and (6), is classified to section 1813 of Title 12, Banks and Banking.

Section 5.35(3), of the Farm Credit Act of 1971, referred to in par. (4), is classified to section 2271(3) of Title 12.

Section 25 of the Federal Reserve Act, referred to in par. (8), is classified to subchapter I (section 601 et seq.) of chapter 6 of Title 12, Banks and Banking.

Section 25(a) of the Federal Reserve Act, referred to in par. (8), is classified to subchapter II (section 611 et seq.) of chapter 6 of Title 12.

Section 1(b) of the International Banking Act of 1978, referred to in par. (9), is classified to section 3101 of Title 12.

1990 Amendment

Pars. (7)–(9). Pub.L. 101–647 added pars. (7) to (9).

1989 Amendment

Pub.L. 101–73 transferred former subsection (b) of section 215 of this title to this section and, in this section as so transferred, added section heading, in provisions preceding par. (1) struck out former "(b)" designation and substituted "this title" for "this section", in par. (1) substituted "an insured depository institution (as defined in section 3(c)(2) of the Federal Deposit Insurance Act)" for "a bank with deposits insured by the Federal Deposit Insurance Corporation", redesignated pars. (3) to (7) as (2) to (6), respectively, and struck out former par. (2), reading "an institution with accounts insured by the Federal Savings and Loan Insurance Corporation", in par. (4), as so redesignated, substituted "a System institution of the Farm Credit System, as defined in section 5.35(3) of the Farm Credit Act of 1971

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FEDERAL SENTENCING GUIDELINE

See §§ 2B1.1, 2B4.1, 2F1.1.

CHAPTER 2—AIRCRAFT AND MOTOR

§ 31. Definitions

When used in this chapter the term—

"Aircraft engine", "air navigation facility", "appliance", "
commerce", "interstate air commerce", "landing area", "over
peller", "spare part" and "special aircraft jurisdiction of the
the meaning ascribed to those terms in the Federal Aviatior

"Motor vehicle" means every description of carriage or oth
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transportation of passengers, passengers and property, or p

"Destructive substance" means any explosive substance, fl
machine, or other chemical, mechanical, or radioactive device
contaminative, corrosive, or explosive nature;

"Used for commercial purposes" means the carriage of pe
fare, fee, rate, charge or other consideration, or directly or in
any business, or other undertaking intended for profit;

"In flight" means any time from the moment all the exter
closed following embarkation until the moment when any
disembarkation. In the case of a forced landing the flight sh
until competent authorities take over the responsibility for th
and property on board; and

"In service" means any time from the beginning of pr
aircraft by ground personnel or by the crew for a specific fli

FOIA #57720 (URS 16326) Docid: 7010531 Page 143

offense" means a Class B misdemeanor, a Class
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101 Stat. 1279, and amended Pub.L. 100–690, Title VII,

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For legislative history and purpose of Pub.L. 100–185, see 1987 U.S.Code Cong. and Adm. News, p. 2137. See, also, Pub.L. 100–690, 1988 U.S.Code Cong. and Adm.News, p. 5937.

OF DECISIONS

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Statute defining the term "petty offense" did not create entitlement to jury trial, even in cases of criminal contempt where prison sentence might be imposed; purpose of statute was simply to limit prison time for crimes covered by section to six months, without forbidding it, and to put $5,000 cap on permissible fines. U.S. v. Kozel, C.A.7 (Ill.) 1990, 908 F.2d 205, certiorari denied 111 S.Ct. 969, 498 U.S. 1089, 112 L.Ed.2d 1055.

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ncial institution" means—

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ts insured by the National Credit Union Share

a member, as defined in section 2 of the Federal
1422), of the Federal home loan bank system;
Farm Credit System, as defined in section 5.35(3)

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(15 U.S.C. 662);

ing company (as defined in section 3(w)(1) of the

a member bank of the Federal Reserve System;
nder section 25 or section 25(a) of the Federal

foreign bank (as such terms are defined in
1(b) of the International Banking Act of 1978).

e II, § 1107(a), 98 Stat. 2145, § 215(c); renumbered
L. 99–370, § 2, 100 Stat. 779; renumbered § 20 and
IX, § 962(e)(1), (2), 103 Stat. 503; Nov. 29, 1990, Pub.L.
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Section 5.35(3), of the Farm Credit Act of 1971, referred to in par. (4), is classified to section 2271(3) of Title 12.

Section 25 of the Federal Reserve Act, referred to in par. (8), is classified to subchapter I (section 601 et seq.) of chapter 6 of Title 12, Banks and Banking.

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Section 1(b) of the International Banking Act of 1978, referred to in par. (9), is classified to section 3101 of Title 12.

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1986 Amendment

Pub.L. 99–370 expanded and generally revised the definition of "financial institution".

Separability of Provisions

If any provision of Pub.L. 101–73 or the application thereof to any person or circumstance is held invalid, the remainder of Pub.L. 101–73 and the application of the provision to other persons not similarly situated or to other circumstances not to be affected thereby, see section 1221 of Pub.L. 101–73, set out as a note under section 1811 of Title 12, Banks and Banking.

Legislative History

For legislative history and purpose of Pub.L. 101–73, see 1989 U.S.Code Cong. and Adm. News, p. 86. See, also, Pub.L. 101–647, 1990 U.S.Code Cong. and Adm.News, p. 6472.

FEDERAL SENTENCING GUIDELINES

See §§ 2B1.1, 2B4.1, 2F1.1.

CHAPTER 2—AIRCRAFT AND MOTOR VEHICLES

§ 31. Definitions

When used in this chapter the term—

"Aircraft engine", "air navigation facility", "appliance", "civil aircraft", "foreign air commerce", "interstate air commerce", "landing area", "overseas air commerce", "propeller", "spare part" and "special aircraft jurisdiction of the United States" shall have the meaning ascribed to those terms in the Federal Aviation Act of 1958, as amended.

"Motor vehicle" means every description of carriage or other contrivance propelled or drawn by mechanical power and used for commercial purposes on the highways in the transportation of passengers, passengers and property, or property or cargo;

"Destructive substance" means any explosive substance, flammable material, infernal machine, or other chemical, mechanical, or radioactive device or matter of a combustible, contaminative, corrosive, or explosive nature;

"Used for commercial purposes" means the carriage of persons or property for any fare, fee, rate, charge or other consideration, or directly or indirectly in connection with any business, or other undertaking intended for profit;

"In flight" means any time from the moment all the external doors of an aircraft are closed following embarkation until the moment when any such door is opened for disembarkation. In the case of a forced landing the flight shall be deemed to continue until competent authorities take over the responsibility for the aircraft and the persons and property on board; and

"In service" means any time from the beginning of preflight preparation of the aircraft by ground personnel or by the crew for a specific flight until twenty-four hours

UNITED STATES CODE CONGRESSIONAL AND ADMINISTRATIVE NEWS

98th Congress—Second Session 1984

Convened January 23, 1984

Adjourned October 12, 1984

Volume 2

PUBLIC LAWS 98–473 to 98–623
[98 Stat. pages 1837 to 3414]
PRIVATE LAWS 98–47, 98–53

LEGISLATIVE HISTORY
[PUBLIC LAWS 98–216 to 98–276]

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PUBLIC LAW 98-473 [H.J.Res. 648]; October 12, 1984

CONTINUING APPROPRIATIONS, 1985—COMPREHENSIVE CRIME CONTROL ACT OF 1984

For Legislative History of Act, see p. 3182

Joint Resolution making continuing appropriations for the fiscal year 1985, and for other purposes.

TITLE I

That the following sums are hereby appropriated, out of any money in the Treasury not otherwise appropriated, and out of applicable corporate or other revenues, receipts, and funds, for the several departments, agencies, corporations, and other organizational units of the Government for the fiscal year 1985, and for other purposes, namely:

Agriculture, rural development appropriations.

SEC. 101. (a) Such sums as may be necessary for programs, projects, or activities provided for in the Agriculture, Rural Development and Related Agencies Appropriation Act, 1985 (H.R. 5743), to the extent and in the manner provided for in the conference report and joint explanatory statement of the Committee of Conference (House Report Numbered 98-1071), filed in the House of Representatives on September 25, 1984, as if such Act had been enacted into law.

D.C. appropriations.

(b) Such sums as may be necessary for programs, projects, or activities provided for in the District of Columbia Appropriation Act, 1985 (H.R. 5899), to the extent and in the manner provided for in the conference report and joint explanatory statement of the Committee of Conference (House Report Numbered 98-1088), filed in the House of Representatives on September 26, 1984, as if such Act had been enacted into law.

(c) Such amounts as may be necessary for programs, projects or activities provided for in the Department of the Interior and Related Agencies Appropriations Act, 1985, at a rate of operations and to the extent and in the manner provided as follows, to be effective as if it had been enacted into law as the regular appropriation Act:

Post, p. 1838.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 146

PART N—RACKETEERING IN OBSCENE MATTER

SEC. 1020. Section 1961(1) of title 18, United States Code, is amended— *Ante*, p. 2136.

(1) in clause (A) by inserting after "extortion," the following: "dealing in obscene matter,"; and

(2) in clause (B) by inserting after "section 1343 (relating to wire fraud)," the following: "sections 1461-1465 (relating to obscene matter),".

CHAPTER XI—SERIOUS NONVIOLENT OFFENSES

Crimes and misdemeanors. Penalties.

PART B—WARNING THE SUBJECT OF A SEARCH

SEC. 1103. Section 2232 of title 18 of the United States Code is amended—

(a) by deleting in the first paragraph "shall be fined not more than $2,000 or imprisoned not more than one year, or both" and inserting in lieu thereof "shall be fined not more than $10,000 or imprisoned more than five years, or both;

(b) by adding a new paragraph as follows:

"Whoever, having knowledge that any person authorized to make searches and seizures has been authorized or is otherwise likely to make a search or seizure, in order to prevent the authorized seizing or securing of any person, goods, wares, merchandise or other property, gives notice or attempts to give notice of the possible search or seizure to any person shall be fined not more than $10,000 or imprisoned not more than five years, or both.".

PART C—PROGRAM FRAUD AND BRIBERY

SEC. 1104. (a) Chapter 31 of title 18 of the United States Code is amended by adding a new section 666 as follows:

State and local governments. 18 USC 666.

"§ 666. Theft or bribery concerning programs receiving Federal funds

"(a) Whoever, being an agent of an organization, or of a State or local government agency, that receives benefits in excess of $10,000 in any one year period pursuant to a Federal program involving a grant, a contract, a subsidy, a loan, a guarantee, insurance, or another form of Federal assistance, embezzles, steals, purloins, willfully misapplies, obtains by fraud, or otherwise knowingly without authority converts to his own use or to the use of another, property having a value of $5,000 or more owned by or under the care, custody, or control of such organization or State or local government agency, shall be imprisoned for not more than ten years and fined not more than $100,000 or an amount equal to twice that which was obtained in violation of this subsection, whichever is greater, or both so imprisoned and fined.

"(b) Whoever, being an agent of an organization, or of a State or local government agency, described in subsection (a), solicits, demands, accepts, or agrees to accept anything of value from a person or organization other than his employer or principal for or because of the recipient's conduct in any transaction or matter or a series of transactions or matters involving $5,000 or more concerning the affairs of such organization or State or local government agency, shall be imprisoned for not more than ten years or fined not

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 147

"(1) the term 'counterfeited' means a document that purports to be genuine but is not, because it has been falsely made or manufactured in its entirety;

"(2) the term 'forged' means a document that purports to be genuine but is not because it has been falsely altered, completed, signed, or endorsed, or contains a false addition thereto or insertion therein, or is a combination of parts of two or more genuine documents;

"(3) the term 'security' means—

"(A) a note, stock certificate, treasury stock certificate, bond, treasury bond, debenture, certificate of deposit, interest coupon, bill, check, draft, warrant, debit instrument as defined in section 916(c) of the Electronic Fund Transfer Act (15 U.S.C. 1693(c)), money order, traveler's check, letter of credit, warehouse receipt, negotiable bill of lading, evidence of indebtedness, certificate of interest in or participation in any profit-sharing agreement collateral-trust certificate, pre-reorganization certificate of subscription, transferable share, investment contract, voting trust certificate, or certificate of interest in tangible or intangible property; 15 USC 1693n.

"(B) an instrument evidencing ownership of goods, wares, or merchandise;

"(C) any other written instrument commonly known as a security;

"(D) a certificate of interest in, certificate of participation in, certificate for, receipt for, or warrant or option or other right to subscribe to or purchase, any of the foregoing; or

"(E) a blank form of any of the foregoing;

"(4) the term 'organization' means a legal entity, other than a government, established or organized for any purpose, and includes a corporation, company, association, firm, partnership, joint stock company, foundation, institution, society, union, or any other association or persons which operates in or the activities of which affect interstate or foreign commerce; and

"(5) the term 'State' includes a State of the United States, the District of Columbia, Puerto Rico, Guam, the Virgin Islands, and any other territory or possession of the United States.".

(b) The analysis at the beginning of chapter 25 of title 18 is amended by adding after the item relating to section 509 the following:

"510. Securities of the State and private entities.".

Part E—Receipt of Stolen Bank Property

Sec. 1106. Subsection (c) of section 2113 of title 18 is amended to read as follows:

"(c) Whoever receives, possesses, conceals, stores, barters, sells, or disposes of, any property or money or other thing of value which has been taken or stolen from a bank, credit union, or savings and loan association in violation of subsection (b), knowing the same to be property which has been stolen shall be subject to the punishment provided in subsection (b) for the taker.".

Part F—Bank Bribery

Sec. 1107. (a) Section 215 of title 18 is amended to read as follows:

"(a) Whoever, being an officer, director, employee, agent, or attorney of any financial institution, bank holding company, or savings and loan holding company, except as provided by law, directly or indirectly, asks, demands, exacts, solicits, seeks, accepts, receives or agrees to receive anything of value, for himself or for any other person or entity, other than such financial institution, from any person or entity for or in connection with any transaction or business of such financial institution; or

"(b) Whoever, except as provided by law, directly or indirectly, gives, offers, or promises anything of value to any officer, director, employee, agent, or attorney of any financial institution, bank holding company, or savings and loan holding company, or offers or promises any such officer, director, employee, agent, or attorney to give anything of value to any person or entity, other than such financial institution, for or in connection with any transaction or business of such financial institution, shall be fined not more than $5,000 or three times the value of anything offered, asked, given, received, or agreed to be given or received, whichever is greater, or imprisoned not more than five years, or both; but if the value of anything offered, asked, given, received, or agreed to be given or received does not exceed $100, shall be fined not more than $1,000 or imprisoned not more than one year, or both.

"(c) As used in this section—

"(1) 'financial institution' means—

"(A) any bank the deposits of which are insured by the Federal Deposit Insurance Corporation;

"(B) any member, as defined in section 2 of the Federal Home Loan Bank Act, as amended, of the Federal Home Loan Bank System and any Federal Home Loan Bank;

12 USC 1422.

"(C) any institution the accounts of which are insured by the Federal Savings and Loan Insurance Corporation;

"(D) any credit union the accounts of which are insured by the Administrator of the National Credit Union Administration;

"(E) any Federal land bank, Federal land bank association, Federal intermediate credit bank, production credit association, bank for cooperatives; and

"(F) a small business investment company, as defined in section 103 of the Small Business Investment Act of 1958 (15 U.S.C. 662); and

"(2) 'bank holding company' or 'savings and loan holding company' means any person, corporation, partnership, business trust, association or similar organization which controls a financial institution in such a manner as to be a bank holding company or a savings and loan holding company under the Bank Holding Company Act Amendments of 1956 (12 U.S.C. 1841) or the Savings and Loan Holding Company Amendments of 1967 (12 U.S.C. 1730a).

12 USC 1841 note.

"(d) This section shall not apply to the payment by a financial institution of the usual salary or director's fee paid to an officer, director, employee, agent, or attorney thereof, or to a reasonable fee paid by such financial institution to such officer, director, employee, agent, or attorney for services rendered to such financial institution.".

12 USC 1701 note.

Repeal.

(b) Section 216 of title 18 is repealed, and the section analysis of chapter 11 for section 216 be amended to read:

18 USC 216.

"216. Repealed.".

18 U.S.C. § 1001
1001

TELECOPY COVER SHEET

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 151

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-- DRAFT 3/1/95 --

MEMORANDUM

TO: Alex Azar

FROM: Rajeev Duggal

DATE: March 1, 1995

RE: Research Regarding 18 U.S.C. § 1001

Summary

You have requested preliminary research regarding the issue of whether or not an official of the Executive Branch who has made false statements and has concealed information in a Congressional oversight hearing is prosecutable under 18 U.S.C. § 1001. What follows are the preliminary results of that research. As you will see, substantial additional research will be required before charging decisions are made.

Discussion

Section 1001, the false statements statute, states:

> Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both.

18 U.S.C. § 1001. There are three distinct offenses that fall within Section 1001: 1) concealing a material fact; 2) making a false statement; and 3) making or using a false writing or document. See id.; Edward J. Devitt et al., Federal Jury Practice and Instructions, Criminal § 37.00, at 411 (4th ed. 1990); Jennifer L. Kraft & David A. Sadoff, Ninth Survey of White Collar Crime, False Statements, 31 Am. Crim. L. Rev. 539, 540 (1994).

In order to convict a defendant under Section 1001 for making a false statement or writing or concealing a material fact, it must be proven that 1) the defendant knowingly and willfully; 2) made a false statement or writing or by trick, scheme, or device concealed a fact; 3) that was material; 4) in any matter within the jurisdiction of a department of the United States. United States v. Swaim, 757 F.2d 1530, 1533 (5th Cir.), cert. denied, 474 U.S. 825

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 152

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(1985) (concealing fact case); Freidus v. United States, 223 F.2d 598, 601 (D.C. Cir. 1955) (false statement case); United States v. Weinberger, Crim. A. No. 92-235, 1992 WL 294877, at *4 (D.D.C. Sept. 29, 1992) (false statement case); United States v. Dale, 782 F. Supp. 615, 626 (D.D.C. 1991) (concealing fact case).

a. Knowing and Willful False Statement

In a false statement or writing case, it must be shown that the defendant "had the specific intent to make a false or fraudulent statement." United States v. Lange, 528 F.2d 1280, 1288 (5th Cir. 1976). This is established if the statement or writing is "untrue when made, and known at the time to be untrue by the person making it." United States v. Milton, 8 F.3d 39, 46 (D.C. Cir. 1993) (quoting jury instruction). The jury makes this determination of falsity by "considering the [statement] in context and taking into account the setting in which it appeared and the purpose for which it was used." Id. at 45. The jury must "determine how the defendant construed the question or answer and . . . decide, in that light, whether the defendant knowingly gave a false answer." Id. at 46.

b. Knowing and Willful Concealment of Fact

In a concealment case, it must be shown that the defendant 1) had a duty to disclose the fact and 2) used a "trick, scheme, or device" in concealing the fact.[1]

"It [is] incumbent on the Government to prove that the defendant had a duty to disclose the material facts at the time he was alleged to have concealed them." United States v. Irwin, 654 F.2d 671, 678 (10th Cir. 1981); United States v. Mattox, 689 F.2d 531, 533 (5th Cir. 1982) ("Silence may be falsity when it misleads, particularly if there is a duty to speak."). Under 2 U.S.C. § 192, it is clear that a summoned witness has a duty to disclose facts inquired of in a Congressional hearing.

In the absence of a Congressional summons, it may nevertheless be possible to establish that a duty to disclose exists as to an Executive Branch official testifying in a Congressional oversight hearing by virtue of the official's requirement to report to Congress. For example, the Thrift Depositor Oversight Protection Board, which includes the CEO of the RTC, is required to appear before the House and Senate Banking Committees. 12 U.S.C. § 1441a(k)(6)(A) (requiring semiannual appearance). As such, it may be possible that such a requirement to appear implies a duty to disclose. Additional research is required as to this issue.

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[1] One who makes a knowing failure to disclose a material fact is as culpable as one who makes a false statement. See United States v. McCarthy, 422 F.2d 160, 162 (2d Cir. 1970) ("Leaving a blank is equivalent to an answer of 'none' or a statement that there are no facts required to be reported.")

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 153

10/11/95 09:03 202 514 8802 OIC →→→ OIC LR 003

In order to satisfy the "trick, scheme, or device" requirement, it must be shown that there was an "affirmative act" by which means a material fact was concealed. United States v. London, 550 F.2d 206, 212-13 (5th Cir. 1977). "The mere omission of failing truthfully to disclose a material fact, which is simply the negative aspect of the affirmative act of falsely stating the same material fact, does not make out an offense under the conceal or cover up clause of section 1001." Id. at 213-14. "Rather the latter clause of section 1001 requires the government to prove something more [--] that the material fact was affirmatively concealed by ruse or artifice, by scheme or device." Id. at 214.

However, "a person's deliberate failure to disclose to the government material facts, in the face of a duty to disclose such facts, constitutes an 'affirmative act' within the contemplation of the statute." United States v. Dale, 782 F. Supp. 615, 626 (D.D.C. 1991) (Penn, J., citing no authority). Thus, this situation is distinguishable from "passive failure to disclose" or "mere silence in the face of an unasked question." Id. "The case law is clear that the deliberate failure to disclose material facts in the face of a specific duty to disclose such information constitutes a violation of the concealment provision of section 1001." Id.

c. Applicability of Brontson: Whether or Not Nonresponsive Answers Can Constitute Concealment of Material Facts Under Section 1001

The issue here relates to the difference between questioning in a congressional setting versus an adversarial trial setting. In Brontson, a perjury case, the Court held that the perjury statute was to be strictly construed such that if a witness 1) speaks the literal truth or 2) is nonresponsive to a question and thereby succeeds in concealing certain facts, the witness is not culpable for perjury. Brontson v. United States, 409 U.S. 352, 360 (1973). "The burden is on the questioner to pin the witness down to the specific object to the questioner's inquiry." Id. "Unresponsive answers are to be remedied through the 'questioner's acuity' and not by a federal perjury prosecution." Id. at 362.

The Court reasoned that "[i]t is the responsibility of the lawyer to probe; testimonial interrogation, and cross-examination in particular, is a probing, prying, pressing form of inquiry. If a witness evades, it is the lawyer's responsibility to recognize the evasion and bring the witness back to the mark, to flush out the whole truth with the tools of adversary examination." Id. at 358-59. That is so because "[i]t should come as no surprise that a participant in a bankruptcy proceeding may have something to conceal and consciously tries to do so; or that a debtor may be embarrassed at his plight and yield information reluctantly." Id. at 358.

This Brontson line of thought -- that the questioner has a high burden that inures to the benefit of the witness -- has been extended by some courts to section 1001 cases. The issue is whether or not this extension is proper or whether Brontson should be limited to perjury or false statements cases occurring in an adversarial trial context or whether it should

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 154

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be extended to all cases falling within those statutes, including concealment cases.[2]

If Brontson applies not only to the false statements prong of section 1001 but also to the concealment aspect, little would be left of concealment as a separate and distinct offense under section 1001. Substantial additional research must be conducted on this issue.

d. Materiality

The materiality determination is a matter of law to be determined by the courts. United States v. Hansen, 772 F.2d 940, 950 (D.C. Cir. 1985) (Scalia, J.) (concealment case).[3] The test for materiality is whether the statement "has a natural tendency to influence or was capable of influencing, the decision of the tribunal in making a particular determination." Id. at 948. Proof of actual reliance on the statement is not necessary. Id. As such, "a lie influencing the possibility that an investigation might commence" stands in the same posture under section 1001 as "a lie distorting an investigation already in progress." Id.

From the language of the statute, it is clear that the "materiality" element is not repeated in the second and third prongs. However, it is clear that the courts have read the materiality element in to each clause. See United States v. Notarantonio, 758 F.2d 777, 785 (1st Cir. 1985).[4]

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[2] The D.C. Circuit accepted the Brontson defense that a literally true response is non-prosecutable in a false statements case. United States v. Milton, 8 F.3d 39, 45 (D.C. Cir. 1993).

[3] Some Circuits hold that materiality is an issue for the jury.

[4] In Swaim, the court couched its language in terms of concealment as well as false statements:

> The charge of materiality requires only that the fraud in question have a natural tendency to influence, or be capable of affecting or influencing, a government function. The alleged concealment or misrepresentation need not have influenced the actions of the government agency, and the government agents need not have been actually deceived.
>
> The Government does not have to show actual reliance on false statements or documentation. A statement is material even if it is ignored or never read by the agency receiving the misstatement. The concealment must simply have the capacity to impair or pervert the functioning of a government agency.

United States v. Swaim, 757 F.2d 1530, 1533 (5th Cir. 1985).

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 155

10/11/95 09:04 202 514 8802 OIC ←← OIC LR 005

e. Statements to Congress

The false statement, false writing, or concealed fact must relate to a matter within the jurisdiction of a department of the United States. Although "Congress" does not come squarely within the definition of an "agency" or "department," the Supreme Court has held that the term "department" was meant to describe the executive, legislative, and judicial branches of government. United States v. Bramblett, 348 U.S. 503, 509 (1955). As such a congressional committee is a department for section 1001 purposes. United States v. Poindexter, 951 F.2d 369, 387 (D.C. Cir. 1991) (section 1001 applied to false statements made by Poindexter to members of House Intelligence Committee); United States v. Hansen, 772 F.2d 940, 943-44 (D.C. Cir. 1985) (forms submitted by congressman to House Committee as required by Ethics in Government Act involve "matter within the jurisdiction of a department.") In addition, section 1001 is applicable to "statements that were not under oath and were not stenographically transcribed." Poindexter, 951 F.2d at 387-88 (section 1001 applies to private discussions between Poindexter and Congressmen; problems of proof in such situations (one person's word against another) are issues for sufficiency of evidence not substantive law).

In Hubbard, the Supreme Court is currently being asked to limit the reach of section 1001 solely to executive agencies. The outcome of Hubbard would significantly limit the applicability of section 1001 in the context of unsworn Executive testimony before Congressional oversight committees.

Conclusion

If you have any questions, please let me know.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 156

10/11/95 09:05 202 514 8802 OIC ←← OIC LR 006

Supplement to Memorandum

I. Duty to Disclose Cases

United States v. Irwin, 654 F.2d 671 (10th Cir. 1981)

Defendant enters into contract with City Council to provide assistance in obtaining federal and state funds to finance a project. He was to receive compensation based on amount of grant received. He was then informed that this was illegal, but proceeded to enter into a second contract of the same nature. Defendant submitted grant application to Economic Development Administration (EDA) that was approved. Defendant was then appointed to City Council and was in charge of disbursing funds from EDA grant and approved City Council bills paid by EDA grant. Defendant approved bills that were allegedly performed by the defendant. In statement to EDA , defendant either left blank or claimed that he had received "0" compensation, when in fact he had been paid. Court holds that "the jury is able to find beyond a reasonable doubt that a false statement was made on the grant application concerning the amount of compensation paid by city council to defendant for expediting the application and that defendant knowingly and willfully made the false statement. In respect to the duty to disclose, the Court believes it was incumbent on the Government to prove that defendant had a duty to disclose the material facts at the time he was alleged to have concealed them. The Government in this case failed to show a legal duty to disclose subcontractors bills to City Council the payments made by subcontractor to defendant.

United States v. Hansen, 772 F.2d 940 (D.C. Cir. 1985)

The defendant, a former congressman, was convicted for false statements to a federal agency, here under the Ethics in Government Act (EIGA). Defendant failed to disclose bank loans to his wife, commodities profits, and other personal loans. EIGA requires members of Congress to file annual financial disclosure reports. Defendant challenged the conviction on materiality, jurisdiction, and whether § 1001 has application to EIGA violations. Court says that the statute is one of general applicability..."it's sweeping language clearly embraces the omissions on defendants EIGA forms." Court ruled that House Committee's are federal departments for purposes of § 1001. The subject of forms is also a matter within the jurisdiction of the department since the Supreme Court has held that the phrase should not be given narrow or technical meaning. Affirmed.

United States v. Zalman, 870 F.2d 1047 (6th Cir. 1989)

Defendant was convicted on two counts of aiding and abetting individuals to make false statements to the Immigration and Naturalization Service (INS). Defendant assisted individuals in arranging fixed marriages in order to remain in the U.S., therefore misleading the INS. Defendant has charged as error the trial court's failure to instruct the jury as to the

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 157

10/11/95 09:06 202 514 8802 OIC ←← OIC LR 007

government's burden to prove that he or his clients had a duty to disclose the purposes of their marriages. Court holds that the defendant was correct in asserting that to support a concealment case there must be a duty to disclose. However, the defendant's assertion is misplaced because the issue of duty and proof thereof is not a question of fact to be decided by a jury. It is a question of law properly considered and determined by the court. United States v. Tobon-Builes, 706 F.2d 1092 (11th Cir. 1983) Consequently, there was no requirement imposed upon the trial court to instruct the jury as to the issue of duty as an element of the concealment offense. Affirmed.

II. Bronston Issue Cases

United States v. Milton, 8 F.3d 39 (D.C. Cir. 1993)

Defendant was convicted of making materially false statements under § 1001. Defendant was employed as a staff attorney for the Equal Employment Opportunity Commission (EEOC). In settlement of a case, defendant was to deposit a $1,000,000 check into an EEOC account to be distributed to job applicants who had been discriminated against. Instead he deposited it into separate account, had claimants submit false claims, gave them money from separate account, and then collected it in cash from false claimants. Defendant stated that statements of claims were literally true. Court states that the defense of literal truth applies to § 1001 prosecutions, but defendant proposed no jury instructions to this effect, raised no objections on instructions given, and did not argue this defense to the court or jury. (However, court rules that defendant preserved objection to literal truth argument in motion of acquittal.) Affirmed.

United States v. Clarridge, 811 F. Supp. 697 (D.D.C. 1992)

Defendant, a senior officer at the CIA, was indicted on seven counts relating to the Iran-Contra affair, six of these as a result of his testimony to a Congressional committees. The basis for the perjury and false statement charges is that defendant lied about when he first learned that the U.S. was shipping arms to Iran. Defendant challenges multiplicity of counts. The Court states that the test for multiplicity is that "each count must set forth a separate lie or false statement, and in the cases where the facts present a close question of whether separate lies exist it is relevant to inquire into the degree in which the second statement impaired the body before which it was made." The Court then addresses separate counts out of appearances before separate committees being multiplicitous. Court states that defendants testimony before different committees on different dates cannot, under any interpretation, constitute the same offense for multiplicity purposes. (Even if they were the exact same lies.) Court holds the same answers to essentially identical questions are multiplicitous. Here the defendant was responding to the same line of questioning by the same person on behalf of the same body on each occasion, and the repetition of the alleged lie did not further impair the operations of the committee. The defendant then moves to dismiss the counts on the grounds that they are literally true. The court holds that the indictment is sufficient if it contains the elements of the offense charged and fairly informs a defendant of the charge against him. The indictment in this case meets this standard, falsity is an element of both § 1001 and § 1621. The possibility that a question or answer may have a number of interpretations does

10/11/95 09:06 202 514 8802 OIC ←←← OIC LR 008

not invalidate the indictment/conviction. Statements where there is one or more arguable constructions, that question is left for the jury. Court reduces charges from seven to five, all other motions denied.

United States v. Poindexter, 951 F.2d 369 (D.C. Cir. 1991)

Defendant was convicted on several charges, including making false statements to Congress. Defendant falsely stated to members of the House Intelligence Committee that he had not learned until January 1986 that missiles had been shipped in November 1985 and that he had not learned until November 1986 that anyone in the U.S. Government might have had prior knowledge of that shipment. Defendant asserts that § 1001 does not apply to a false but unsworn and untranscribed oral statement made by an official in the Executive branch to members of Congress acting in their "legislative capacity." Court has held that a congressional committee is a department for the purposes of § 1001. United States v. Hansen) Defendant attempts to distinguish Hansen, saying that it involved Congress' housekeeping function, not its true legislative function. Defendant also points out that Courts' have recognized a "judicial function" exception, making § 1001 inapplicable to conduct occurring before a court acting in its judicial capacity, and that this rationale equally supports an exception for the "legislative function." The Court does not accept this, "we doubt that traditional trial tactics rationale shields from criminal responsibility a defendant who knowingly makes a material false statement of fact in a judicial proceeding. " (Remanded due to Independent Counsel's inability to carry burden of showing that defendant's compelled testimony was not used against him at trial.)

United States v. Mayer, 775 F.2d 1387 (9th Cir. 1985)

Defendant was convicted under § 1001 with submitting fictitious letters of recommendation to the District Court for consideration when it sentenced him on an unrelated conviction. This circuit had previously recognized that application of § 1001 should be limited to matters arising in judicial proceedings that can be characterized as 'administrative' or 'housekeeping' functions of the court. The Court concludes that the defendant's sentencing hearing constituted a judicial proceeding for purposes of § 1001, and that the district judge's sentencing determination constituted an adjudicative function. The judge's role in sentencing is not a housekeeping or administrative duty, but is an extension of the defendant's trial itself. Therefore, misrepresentations made during a sentencing hearing would not be covered under § 1001. Reversed.

United States v. Abrahams, 604 F.2d 386 (5th Cir. 1979)

In a proceeding in front of a magistrate to determine defendant's bail for another conviction the defendant made false, unsworn statements as to his identity and past criminal record. The Court addresses the question of whether a false statement made in a judicial proceeding is a proper basis for a prosecution under § 1001. Court holds that conviction must be reversed because § 1001 does not apply to the introduction of false documents as evidence in a criminal proceeding.

10/11/95 09:07 202 514 8802 OIC ←←← OIC LR 009

United States v Harrod, 981 F.2d 1171 (10th Cir. 1992)

Defendant convicted of making a false statement to the Department of Labor Workers Compensation Office. In order to receive benefits for his disability, defendant had to complete a federal form annually. Questions from form that are at issue regard if he was employed, number of hours employed, and rate of pay. In the years of 1988-1990 defendant claimed that he was not employed, only had a hobby, that he worked on it 4-6 hours per week. Defendant also left some questions blank. His "hobby" yielded $5,000 in 1988, $16,000 in 1989, and $34,000 in 1990. Defendant cites Bronston, saying an unresponsive answer cannot be the basis for a perjury prosecution. Court rules that Bronston does not apply here because it was decided under a federal perjury statute, not a § 1001 prosecution. Affirmed.

United States v. Mandanici, 729 F.2d 914 (2nd Cir. 1984)

Defendant convicted for making false statements to Department of Housing and Urban Development(HUD). Defendant made false statements in application, and two contracts with the Government in order to receive subsidies from HUD. Defendant said he would perform work on property that would cost $88,000, well knowing it would not cost this amount. Defendant also made claims in contract that work had already been performed, when in fact it had not, and then signed contract certifying that data contained was true,correct, and complete. Court found no merit in defendant's claim that contract was literally true and further stated that "while a defendant may not be convicted under § 1001 on the basis of a statement that is, although misleading, literally true, the factual premise for application of this principle here is absent." Affirmed.

United States v. Stephenson, 895 F.2d 867 (2nd Cir. 1990)

Defendant was an export licensing officer for the Department of Commerce, convicted for taking bribes in exchange for export licenses. Defendant told applicant that he wanted 5% for the license. Defendant then told another Commerce officer that the applicant offered him a bribe first. Defendant also convicted for making a false statement to a government official when he reported that applicant had offered him a bribe. Defendant argues that statement was literally true. Judge charged jury that it could convict defendant either by finding that he made false statements or that he falsified, concealed his unlawful acts by accusing applicant of offering bribe. Defendant argues that literally true statements cannot be the basis of a § 1001 conviction. Court rules "even if defendant's statement were construed to be literally true , the jury still could have found that he misrepresented and concealed what had occurred. " Affirmed.

10/11/95 09:08 202 514 8802 OIC ←←← OIC LR 010

MEMORANDUM

TO: Alex Azar

FROM: Monica Molloy

DATE: March 28, 1995

RE: More research regarding 18 U. S. C. § 1001

I. 18 U.S.C. 1001, the false statement statute states:

> Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device, a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both.

Here is a simple outline of the offenses contained within § 1001, as well as the elements necessary to convict a person under the statute.

A. Concealing a material fact

1. Defendant knowingly concealed a fact by trick, scheme, or device.
2. Defendant acted willfully
3. The fact concealed was material.
4. Subject matter was within the jurisdiction of a department or agency of the United States.
5. Defendant had a legal duty to disclose the facts he concealed.

B. Making a false, fictitious, or fraudulent statement

1. Defendant knowingly made a false, fictitious, or fraudulent statement.
2. Defendant acted willfully
3. Statement was made within the jurisdiction of a department or agency of the United States.
4. The statement was material.

10/11/95 09:09 202 514 8802 OIC →→ OIC LR 011

C. Making or Using any false writing or document

1. Defendant knowingly made or used a false writing or document containing a false, fictitious, or fraudulent statement.
2. Defendant acted willfully.
3. The writing or document was material.
4. Subject matter was within the jurisdiction of a department or agency of the United States.

II. Discussion

As you can see, there are three separate offenses contained in Section 1001. The first violation is to knowingly and willfully conceal a material fact; second,the prohibition of making any false or fraudulent statements; and lastly the statute prohibits the making or use of any false writing or document. The three offenses have four elements in common, with the offense of concealing a material fact having one additional element, a legal duty to disclose. Following is a brief synopsis of the case law on each element, followed by a discussion of two defenses that have been claimed § 1001 cases.

The elements that must be proven in order to convict a defendant under 18 U. S. C. 1001 for concealment are: 1) knowingly and willfully; 2) concealing and covering up by trick, scheme, or device; 3) a material fact; 4) in any matter within any jurisdiction of a department or agency with in the United States. United States v. Swaim, 757 F.2d 1530, 1533 (5th Cir.), cert. denied, 474 U.S. 825 (1985).

The intent of the defendant must be shown to be knowingly and willfully in a concealment of a fact or false statement case. Lange states that " a violation of § 1001 requires proof that the defendant had the specific intent to make a false or fraudulent statement." United States v Lange, 528 F. 2d 1280, 1288 (5th Cir. 1976) "In order to establish fraudulent intent on the part of a person, it must be established that such person knowingly and intentionally attempted to deceive another." United States v Diggs, 613 F.2d 988, 1000 (D.C.Cir. 1979)

The element of materiality in a false representation case must pass the following test : whether the statement "has a natural tendency to influence, or was capable of influencing, the decision of the tribunal in making a particular determination." United States v. Hansen, 772 F.2d 940, 950 (D.C. Cir. 1985) Proof of actual reliance on the statement is not required; the Government need only make a reasonable showing of its potential effects. United States v. Diggs,613 F.2d 988, 998 (D.C. Cir 1979) (It is clear in the D. C. Circuit that the materiality element is a question to be determined by the court. However in both the 9th and 10th Circuits materiality is a question for the jury and must be proved beyond a reasonable doubt.) Edward J. Devitt et al., Federal Jury Practice and Instructions, Criminal Section 37.00, at 413 (4th ed 1990).

The element of jurisdiction of a department or agency of the United States is undoubtedly a

10/11/95 09:10 202 514 8802 OIC ←← OIC LR 012

question for the court. The scope of a department or agency was meant to describe the executive, legislative, and judicial branches of Government. United States v. Bramblett, 348 U.S. 503, 509 (1955). The court held that the House Office and Finance disbursing office was a "department or agency" of the United States within the meaning of 18 U.S.C. § 1001. Id. As evidenced by the case law, the courts have given the jurisdiction phrase of the statute a very broad scope and I have yet to see a case where the offense was dismissed due to lack of jurisdiction. In the situation at hand I do not believe there will be any difficulty in establishing this element.

A "duty to disclose" is only required in a concealment of a material fact offense. "In prosecuting a § 1001 concealment violation it is incumbent on the government to prove that the defendant had a legal duty to disclose the material facts at the time he was alleged to have concealed them. " United States v Anzalone, 766 F. 2d 676, 683 (1st Cir. 1985) However, "...there is no requirement imposed upon the trial court to instruct the jury as to the issue of duty as an element of the concealment offense." United States v Zalman, 870 F.2d 1047, 1055 (10th Cir. 1989) United States v Larson, 796 F.2d 244, 245 (8th Cir. 1986) (Court held that since defendant had no legal duty to disclose he could not be convicted under § 1001) United States v Irwin, 654 F.2d 671,678 (10th Cir. 1981) (Government failed to prove defendant had a legal duty to disclose facts to the Economic Development Agency.) In Hansen, a D.C. Circuit case, duty to disclose is briefly addressed. Defendant was charged with failure to disclose financial reports under the Ethics in Government Act, where there was obviously a legal duty. The indictments were upheld under § 1001.

III. Defenses

Two defenses that have been raised in false statement cases are the "exculpatory no" doctrine and the good faith defense. The "exculpatory no" doctrine is when a person under criminal investigation makes a simple denial of criminal liability to an investigator cannot then be prosecuted for making a false statement because this would violate their 5th Amendment rights. United States v Cogdell, 844 F.2d 179, 182 (9th Cir. 1988) However affirmative measures designed to mislead and thwart a government are not protected by the doctrine. Edward J. Devitt, Federal Jury Practice and Instructions, Criminal, § 37.00 at 414 (4th ed. 1990). Defendant Oliver North attempted to claim the "exculpatory no" doctrine as an excuse for not responding to the allegations against him. The Court responded" This circuit has not adopted the doctrine, but in any event it is not applicable here....Just as private persons cannot claim the "exculpatory no" doctrine in a claim against the government, government officials cannot claim its protection in seeking to maintain their positions. " United States v North, 788 F. Supp. 364, 369 (D.D.C. 1988) Because the doctrine has not been adopted by the D.C. Circuit and the ruling in the North case, it is highly unlikely that this defense would be successful.

The good faith defense was raised in defense of mail fraud and false statement allegations. The Court stated that "good faith constitutes a complete defense to a charge with the defense of which fraudulent intent is an essential element. ...What I have said respecting good faith as a defense in a mail fraud charge is also applicable to false official statement charges." United

10/11/95 09:10 202 514 8802 OIC ←← OIC LR 013

States v Diggs, 613 F.2d 988,1000 (D.C. Cir. 1979)

IV. The Bronston issue

The issue of whether nonresponsive answers or literally true answers constitute concealment of a material fact has not been decided by the Supreme Court. However, this issue has been decided under the federal perjury statute. In Bronston, the defendant was charged with perjury under 18 U.S.C. § 1621 and the court held that the general federal perjury statute does not reach a witnesses' literally true,or unresponsive answer, even if the witness intends to mislead the questioner by the answer, be it phrased in the negative or the affirmative, is arguably false by implication. Bronston v United States, 409 U.S. 352 (1973). Bronston places the burden of getting the correct answer on the questioner. "It is the responsibility of the lawyer to probe; testimonial interrogation, and cross examination in particular is a probing, prying, pressing form of inquiry. If a witness evades, it is the lawyer's responsibility to recognize the evasion and to bring the witness back to the mark, to flush out the whole truth with the tools of adversary examination." Id. at 358-359.

Milton, a 1993 D.C. circuit case applies the defense of literal truth to § 1001 prosecutions, but fails to distinguish whether this rule applies to both judicial trials and administrative hearings. United States v. Milton, 8 F.3d 39, 45 (D.C. Cir.1993) However a number of courts have actually held that there is a judicial function exception to § 1001. United States v Poindexter, 951 F.2d 369, 386 (D.C. Cir. 1991) United States v Mayer, 775 F.2d 1387, 1388-1392 (9th Cir. 1985) (Section 1001 does not cover submission of fictitious letter of recommendation to sentencing court.); United States v Abrams, 604 F.2d 386, 392-393, (5th Cir. 1979) (Answering magistrate falsely regarding aliases and arrest record at bail hearing not covered by § 1001).

United States v Clarridge, a D.C. District Court case, charges the defendant with offenses under both 18 U.S.C. § 1001, the concealment statute, and 18 U.S.C. § 1621, the federal perjury statute. United States v Clarridge, 811 F. Supp. 697. The defendant requested a motion to dismiss the perjury charges as well as the false statement charges based on the Bronston decision that literally true answers cannot be prosecuted under the statute. Id. at 712. The Court declines to dismiss the Counts on this basis, stating that the defendant "stretched the language" and "may not insulate himself from prosecution by reinterpreting his statements in order to give them a meaning which is literally true." Id. at 712. The court denied the motion in this case, and did not distinguish between § 1001 and § 1621, it only addresses them by saying "the federal perjury statutes." Id. This could be interpreted as either including both sections or only § 1621.

The second circuit has had two cases that have directly addressed this issue of convicting a defendant under § 1001 when statements have been unresponsive, but literally true. United States v Mandanici , where defendant was convicted of making false statements within the jurisdiction of the Department of Urban Housing and Development, states that " a defendant may not be convicted under § 1001 on the basis of a statement that is, although misleading, literally true." United States v Mandanici, 729 F.2d 914, 921 (2nd Cir. 1984) However, the

10/11/95 09:11 202 514 8802 OIC ←←← OIC LR 014

court ruled, in this case, that the factual premise for application of this principle was absent, therefore upholding the conviction under § 1001. Id. The second case, United States v Stephenson, involves making false statements to government agents. United States v Stephenson, 895 F.2d 867 (2nd Cir. 1990) The defendant argued that literally true statements cannot be the basis of a section 1001 conviction, but the jury found that his statements were plainly false. Id. The court said that "even if Stephenson's statement were construed to be literally true, the jury still could have found that he misrepresented and concealed what had occurred." Id. at 874. In Mandanici, it is clear that the Court feels that Bronston is applicable to § 1001 convictions, on the other hand it is also clear from the two cases that there must be a factual premise and that the decision is in the hands of the jury.

The tenth circuit, under the case of United States v Harrod, however disagrees with the second circuit view that Bronston applies to § 1001 cases. United States v Harrod, 981 F.2d 1171, (10th Cir. 1992). Defendant was convicted of making false statements to the Department of Labor's Office of Worker's Compensation. Id. at 1173. The defendant attempted to assert a Bronston defense, stating that an unresponsive answer, if true cannot be the basis of a perjury prosecution even though it may be likely to mislead. Id. The court holds that Bronston does not apply, because it "was decided under the federal perjury statute, 18 U.S.C. § 1621, which implicates significantly different policy concerns than does a prosecution under 18 U.S.C. § 1001." Id. at 1175. The court then goes on to explain that the holding in Bronston states how it is the interrogator's job to pin down the witness with skillfully asked questions. "But no such question and answer interplay exists in an 18 U.S.C. § 1001 false statement action. When seeking information outside the adversarial context of trial, the government needs and expects those who answer its inquiries to answer truthfully and precisely. In such cases, the respondent is not readily available for cross-examination, as in a perjury trial." Id. at 1175. This is the reasoning that we would like to have in the D.C. Circuit, the type that plainly states that Bronston is not applicable to § 1001 cases.

V. Legislative History

18 U.S.C. § 1001 is derived from the original 1909 Criminal Code version of the false claims statute. Since then it has been amended several times, with the most significant revision in 1934. The House report contains a letter from the Attorney General to the chairman of the committee which sets out the purpose and the need for the legislation. "The bill proposes to amend the Criminal Code so as to prohibit injury to and depredations against Government property wherever situated.... there are no Federal statutes under which prosecutions may be had for willful injury to property of the United States." H.R. Rep. No. 1463, 73d Cong., 2d Sess. 1 (1934), Sen. Rep. No. 1202, 73d Cong., 2d Sess. 2 (1934)

10/11/95 09:12 202 514 8802 OIC →→→ OIC LR 015

MEMORANDUM

TO: Alex Azar

FROM: Monica Molloy

DATE: May 17, 1995

RE: Research on 18 U.S.C. §162, Perjury generally, and 18 U.S.C. §1623, False declarations before grand jury or court.

The Modern Federal Jury Instructions define perjury as "the willful giving of false testimony, before a competent tribunal while under oath, knowing the testimony is false as to a material matter." This instruction is applicable to both §1621 and §1623 prosecutions because the substantive elements in these perjury statutes are the same. Sand, Siffert, Loughlin, & Reiss, Modern Federal Jury Instructions, Vol. 1A, Ch. 48 at 48-6 (1995). Although this definition of perjury applies to both §1621 and §1623, there are several differences between the two statutes, therefore they will be addressed separately in this memo.

I. 18 U.S.C. §1621 Perjury generally

Whoever:

(1) having taken an oath before a competent tribunal, officer, or person, in any case in which a law of the United States authorizes an oath to be administered, that he will testify, declare, depose, or certify truly, or that any written testimony, declaration, deposition, or certificate by him subscribed, is true, willfully and contrary to such oath states or subscribes any material matter which he does not believe to be true; or

(2) in any declaration, certificate, verification , or statement under penalty of perjury as permitted under section 1746 of Title 28, United States Code, willfully subscribes as true any material matter which he does not believe to be true;

is guilty of perjury and shall, except as otherwise expressly provided by law, be fined not more than $2,000 or imprisoned not more than five years, or both. This section is applicable whether the statement or subscription is made within or without the United States.

A. Essential Elements

The following essential elements of a perjury conviction under §1621 must be proved beyond a reasonable doubt:

1) the defendant testified under oath in a proceeding for which a law of the United

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 166

10/11/95 09:13 202 514 8802 OIC →→ OIC LR 016

States authorizes the administration of an oath;
2) the oath was administered by a qualified person;
3) the defendant knowingly made the false material statements detailed in the indictment; and
4) the defendant acted willfully and contrary to the oath that was given.

Two of these four elements are for the jury to decide, whether the defendant knowingly gave false testimony and whether the defendant did so willfully. The trial judge decides the under oath element, whether it was properly administered, whether the person administering it was competent, and in a majority of the circuits, materiality. Edward J. Devitt et al., Federal Jury Practice and Instructions, Criminal, Section 43.00 at 43.03 (4th ed 1990) The elements of the crime of perjury under §1621 are set out in United States v. Debrow as: 1)an oath authorized by law of the United States, 2) taken before a competent tribunal, officer or person, and 3) a false statement willfully made as to facts material to the hearing. United States v. Debrow, 346 U.S. 374 (1953).

"The general test for determining whether a false statement is material is if it has a natural tendency to influence, or is capable of influencing, the decision of the fact finder." United States v. Flowers, 813 F.2d 1320, 1325 (4th Cir. 1987) (This is the same test we saw for 18 U.S.C. §1001cases under United States v. Hansen) The D.C. Circuit has adopted the majority decision that materiality is a question of law to be determined by the trial judge. United States v. Bridges, 717 F.2d 1444, 1448 (D.C. Cir. 1983) Sinclair v. United States is the Supreme Court case that supports the rule that "the materiality of what is falsely sworn, when an element of a crime of perjury, is one for the court", however it is noted that this is only dictum. Sinclair v. United States, 279 U.S. 263 (1929) Federal jury instructions as to materiality state that the "materiality of the matter involved in the alleged false testimony-that is a question of law for me to decide. It is not a question of fact for you, the jury, to determine." Sand, Siffert, Loughlin, & Reiss, Modern Federal Jury Instructions, Vol. 1A, Ch. 48 at 48-10, 49 (1995).

B. "Two Witness Rule"

Under § 1621 there is a requirement of corroboration rule , also known as the "Two witness rule." This is a judge made rule of ancient origin that prevents a defendant from being convicted based solely on the uncorroborated testimony of only one witness. Edward J. Devitt et al., Federal Jury Practice and Instructions, Criminal, Section 43.00 at 43.07 (4th ed 1990). Federal jury instructions explain the two witness rule as requiring that "the falsity of the defendant's two statements must be established *either* by the testimony of two witnesses whose testimony you, the jury, believe to be true, *or* by the testimony of one such witness which is corroborated or confirmed by other independent evidence...to substantiate the testimony of one witness." Sand, Siffert, Loughlin, & Reiss, Modern Federal Jury Instructions, Vol. 1A, Ch. 48 at 48-26 (1995). The Supreme Court has also held that "it is the duty of the trial judge, when properly requested, to instruct the jury on this aspect of its function, in order that it may reach a verdict in the exercise of an informed judgment." Weiler v. United States, 323 U.S. 606 (1945).

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C. Literal Truth Defense

The literal truth defense is a defense available under both perjury statutes. It is a defense to a charge of perjury if the evidence shows either: 1) the defendant made a statement in response to a question that was ambiguous or capable of being understood in more than one way, and the answer given by the defendant to one reasonable interpretation of the ambiguous question was not false; or 2) the defendant made a statement in response to a question that was c;ear and unambiguous, but the answer to the clear question was ambiguous and capable of being understood in more than one way, and one reasonable interpretation of the answer was not false. Edward J. Devitt et al., Federal Jury Practice and Instructions, Criminal, Section 43.00 at 43.12 (4th ed 1990). The D.C. Circuit approved an instruction on the literal truth defense, based upon Bronston v. United States, that provides "...a statement is not false if it is literally true and technically responsive. If a statement, or a reasonable interpretation of a statement, made by a defendant is narrowly or literally true, there can be no violation of this statute." United States v. Haldeman, 559 F.2d 31 (D.C. Cir. 1976), United States v. Bronston, 409 U.S. 352 (1973).

II. 18 U.S.C. §1623 False declarations before grand jury or court

(a) Whoever under oath (or in any declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, United States Code) in any proceeding before or ancillary to any court or grand jury of the United States knowingly makes any false material declaration or makes or uses any other information , including any book, paper, document, record, recording, or other material, knowing the same to contain any false material declaration, shall be fined not more than $10,000 or imprisoned not more than five years, or both.

A. Essential Elements

Three essential elements must be proved beyond a reasonable doubt in order to prove false declarations:

1) the defendant gave testimony under oath before a federal court or grand jury,
2) the defendant made the false material statement as detailed in the indictment during that testimony, and
3) the defendant knew that the statement was false when he gave the testimony.

Edward J. Devitt et al., Federal Jury Practice and Instructions, Criminal, Section 43.00 at 43.08 (4th ed 1990).

Dunn v. United States concerns the scope of the phrase "ancillary proceeding", more specifically, whether a sworn statement given in an interview at an attorney's office is considered ancillary to a court or grand jury proceeding. Dunn v. United States, 442 U.S. 100 (1979). The government contends that any statement under oath should fall within §1623. The court disagreed and concluded that the statement given in the interview "lacked the degree of formality required by §1623. For the government does not and could not seriously maintain that the interview... constituted a deposition." Id. at 2196.

10/11/95 09:14 ☎202 514 8802 OIC ←←← OIC LR 018

The state of mind requirement under §1623 differs from that of §1621. The requirement of *knowing* in §1623 is less stringent than that of *wilfulness* that is required in §1621. Instruction 48-26-Knowingly states; "If you decide that any of the answers the defendant gave were false , you must then decide whether the defendant gave those answers knowingly. That is, at the time the answers were given, did the defendant know and believe that the answers were false; (and, if so, did the defendant give the answers consciously and in the exercise of his free will.)" Sand, Siffert, Loughlin, & Reiss, Modern Federal Jury Instructions, Vol. 1A, Ch. 48 at 48-54 (1995)

B. §1623(c) Multiple Declarations

§1623 (c)-An indictment or information for violation of this section alleging that, in any proceedings before or ancillary to any court or grand jury of the United States, the defendant under oath has knowingly made two or more declarations, which are inconsistent to the degree that one of them is necessarily false, need not specify which declaration is false if -

(1) each declaration was material to the point in question, and

(2) each declaration was made within the statute of limitations for the offense charged under this section.

In any prosecution under this section, the falsity of a declaration set forth in the indictment or information shall be established sufficient for conviction by proof that the defendant while under oath made irreconcilably contradictory declaration material to the point in question in any proceeding before or ancillary to any court or grand jury. It shall be a defense to an indictment or information made pursuant to the first sentence of this subsection that the defendant at the time he made each declaration believed the declaration was true.

"Statements are irreconcilably contradictory if both were made under oath, if both concerned the same subject and if both are inconsistent with each other to such a degree that one of them must be false. The government is not required to prove which irreconcilably contradictory statement is false." Edward J. Devitt et al., Federal Jury Practice and Instructions, Criminal, Section 43.00 at 43.03 (4th ed 1990).

C. §1623(d) Recantation Defense

§1623 (d) Where, in the same continuous court or grand jury proceeding in which a declaration is made, the person making the declaration admits such declaration to be false, such admission shall bar prosecution under this section if, at the time the admission is made, the declaration has not substantially affected the proceeding, or it has not become manifest that such falsity has been or will be exposed.

This defense, also known as the recantation defense, is not available in §1621 prosecutions. The defense contains three elements:

1) the defendant admitted that the statement originally made was false before the same proceeding that heard the original statement,

2) at the time that the false statement was recanted, the false statement had not substantially affected the proceeding, and

3) at the time the false statement was recanted, it had not become obvious that the

10/11/95 09:15 202 514 8802 OIC ←→ OIC LR 019

falsity of that statement had been exposed or would be exposed.
Edward J. Devitt et al., Federal Jury Practice and Instructions, Criminal, Section 43.00 at 43.10 (4th ed 1990).

D. §1623(e)

§1623 (e) Proof beyond a reasonable doubt under this section is sufficient for conviction. It shall not be necessary that such proof be made by any particular number of witnesses or by documentary or other type of evidence.

Section (e) obviously abandons the two witness rule requirement under §1621, proof beyond a reasonable doubt is sufficient. Congress created §1623 because the common law requirements for a perjury prosecution had become exceptionally difficult, hence the abandonment of the two witness rule in §1621. "Congress sought to afford greater assurance than testimony obtained in a grand jury and court proceedings will aid the cause of truth." Dunn v. United States, 442 U.S. 100 (1979).

As a sidenote, a case that I thought might be of interest to you, because of the responses given by the defendant, is Gebhard v. United States, 422 F.2d 281 (9th Cir. 1970). The defendant was charged under §1621. The responses to the questions involved were "I don't recall," "I don't know," or "I don't remember." The court states that "given the nature of these answers it would be difficult to find two witnesses to testify that the defendant did in fact know, believe, or recall a matter which he said he did not." Id. at 287 The court instructed that these charges could be proved by circumstantial evidence. Comment to the Federal Jury Instructions states that "where the responses in issue are answers such as 'I don't know' or 'I don't remember', the governmentmay prove the falsity of the defendant's responses by proof of facts from which the jury may infer that the defendant must have known or remembered that which he denied knowing or remembering while under oath." Sand, Siffert, Loughlin, & Reiss, Modern Federal Jury Instructions, Vol. 1A, Ch. 48 at 48-29 (1995).

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26 U.S.C. § 108 BANKRUPTCY DISCHG.

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A PRIMER ON INCOME TAXES AND THE CANCELLATION OF DEBT

Louisiana State Bar Association

April, 1992

Frederick R. Parker, Jr. [FNa]

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It is not uncommon for a creditor to forgive part or all of a debtor's obligation to him. But beware of the income tax consequences.

It is not uncommon, in these financially troubled times, for a creditor to forgive part or all of a debtor's obligation to him. This "forgiveness" may be prompted by business considerations or ordered by the court in a bankruptcy setting. In either event, the cancellation of debt may give rise to certain income tax consequences to the debtor. This article presents an overview of those (often unexpected) consequences.

Circumstances Giving Rise to COD Income

General Rule

The courts have long recognized the principle that a taxpayer may realize taxable income from the cancellation of indebtedness (often referred to by tax practitioners as "COD income"). This result is the natural corollary to the fundamental rule that, because there was no accession to wealth when the debtor initially incurred the liability, the debt did not give rise to taxable income when created. Where the later forgiveness of the debt gives rise to an accession to wealth represented by either a traceable increase in assets or a previous tax benefit, however, the taxpayer will be called to account to the government for the taxes which otherwise would have been due with respect to his economic gain. This rule first was developed by the courts and later was codified as Section 61(a)(12) of the Internal Revenue Code.

The general rule of income recognition applies only when there exists a traceable increase in the debtor's assets or when the debt has given rise to a tax benefit in his favor. The most obvious example of the former is where the debtor received cash in exchange for his promissory note when the loan initially was confected. [FN1] Other circumstances are not so readily apparent. Query whether a taxpayer would realize COD income from the forgiveness of rent due with respect to his apartment or of a liability for some other nondeductible personal expenditure for which he can show no tangible asset, such as legal services. The same issue would be presented where a taxpayer makes a binding pledge to donate a certain sum of money to a charity and later settles the obligation for something less. While these situations may appear to give rise to COD income when considered from the liability side of the balance sheet, the essential element of a traceable increase in assets may be lacking in each. The analysis focuses on whether the taxpayer experienced a traceable increase in his assets as a result of the forgiveness of the original loan rather than on the mere fact that a debt was forgiven. The reduction of a binding obligation, without more, simply should not give rise to COD income. [FN2]

Alternatively, a taxpayer may realize COD income where the liability itself gives rise to a tax benefit as it accrues. For example, an accrual basis taxpayer who claims deductions for office rent as it becomes due must recognize COD income to the extent his liability is later forgiven. While COD income may be realized under the "traceable increase in assets" theory both by accrual and cash basis taxpayers, only accrual basis taxpayers will realize COD income under the pure "tax benefit" theory. This is so even though cash basis taxpayers in effect

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may receive tax benefits by way of depreciation deductions claimed with respect to property acquired with loan proceeds; such indirect tax benefits are generated from the "traceable increase in assets" engendered by the forgiven loan.

COD Income Versus Gain or Loss from Sale or Exchange

While the foregoing discussion sets forth the general rule that a taxpayer may realize COD income as a result of the cancellation of part or all of a liability, the character of what may appear to constitute ordinary COD income may in fact partially represent gain or loss from the sale of an asset. This result obtains where the taxpayer transfers property in full or partial satisfaction of his liability. The classification of the resulting income is important to the taxpayer for two reasons.

First, COD income is always ordinary income. It is not subject to the rate preferences which otherwise may exist with respect to capital gains, and it may be offset only by a limited amount of capital losses. Gain or loss from the sale or exchange of a capital asset, on the other hand, is capital in nature, with capital gains possibly being taxed at preferential rates and available to absorb capital losses.

The second important distinction between pure COD income and that portion of an exchange which gives rise to exchange gain or loss is that the latter is not excludable from income by taxpayers who are insolvent or in bankruptcy, unlike the COD component of the income which is realized upon a taxpayer's surrender of property in cancellation of his debt.

The determination of the character of income as ordinary COD income or exchange gain or loss depends upon whether the property is given in satisfaction of recourse or nonrecourse debt. COD income clearly will not arise from the transfer of property in satisfaction of either type of debt where the fair market value of the property exceeds the amount of the debt. In this case, the debt simply is paid in full, and the transaction will be treated as if the debtor sold the property at its fair market value and used the proceeds to satisfy his obligation. The exchange therefore will give rise to gain or loss under the general rule of Section 1001 of the Code, measured by the difference between the property's fair market value and its adjusted basis. Accordingly, the character of the gain or loss as ordinary or capital will be determined with reference to the character of the property itself.

A different result obtains, however, when the amount of the outstanding debt exceeds the fair market value of the property given in satisfaction of the debt. In a recourse setting, the transaction is bifurcated into two components: a sale of the property and a forgiveness of the debt. [FN3] The debtor is treated as having sold the property at its fair market value and as having satisfied the debt in full with the proceeds of the deemed sale. He thus will realize a gain or loss on the sale of the property in an amount equal to the difference between the property's fair market value and its adjusted basis. He also will realize COD income to the extent the outstanding balance of the debt exceeds the property's fair market value.

Example

Assume that T transfers securities, purchased several years ago for $1,000 but now valued at $1,800, to C in satisfaction of a $2,000 recourse debt. The value of the securities has been steadily increasing since T acquired them and C is willing to accept them in satisfaction of the debt because of T's shaky financial condition. T will be treated as having sold the securities for $1,800 and as having satisfied his $2,000 liability with that amount of money. Accordingly, T will realize an $800 gain on the deemed sale of the securities (which will be capital in nature if the securities are capital assets), and $200 of COD income. If, on the other hand, the securities are valued at only $800 at the time of the exchange, T will realize a $200 loss on the deemed sale ($800 FMV--$1,000 basis) and $1,200 of COD income ($2,000 debt--$800 deemed payment).

In contrast with the bifurcated analysis of both the asset and liability sides of a transfer of property in satisfaction of a recourse obligation, a transfer in the nonrecourse setting is analyzed only from the asset side. The amount of nonrecourse debt which is discharged as a result of the transfer of the encumbered property is

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simply included in the amount realized on the exchange for purposes of calculating the transferor's gain or loss. The forgiven nonrecourse debt therefore does not give rise to COD income, even though the debt may exceed the fair market value of the property. [FN4]

Exceptions to Recognition of COD Income

Although logical and theoretically defensible, the general rule that a debtor must recognize income from the cancellation of debt often would, if universally applied, strike taxpayers at a time when they are least able to bear the tax consequences. Recognizing that debt cancellation often is the result of a debtor's weak financial condition, Congress responded to the general jurisprudential rule by enacting Section 108 of the Code.

As originally enacted, Section 108 permitted debtors in the business context to exclude from taxation any COD income at the cost of reducing various tax attributes, such as their basis in depreciable property and the amount of otherwise available loss and credit carryovers. Since Section 108 was intended to provide relief to financially distressed debtors caught in the COD income tax trap, the original version of that provision limited its application to taxpayers in "unsound financial condition." This requirement later was dropped because it became difficult to apply, and the benefits of the Section 108 election thus became available both to debtors in financial trouble and to those who were financially sound. The benefits of Section 108 became quite valuable to the latter in the 1980s when they were able to reacquire their own debt from the public at the lower market values caused by rising interest rates. Congress then responded to this unintended benefit to such debtors in 1986 by amending Section 108 and limiting its application to taxpayers whose debt is discharged in bankruptcy or while they are insolvent (the benefits of Section 108 also apply to the cancellation of certain farm indebtedness). As a result, with certain limited exceptions, solvent taxpayers now are required to recognize COD income in the year the discharge of debt occurs.

Bankrupt or Insolvent Debtors

According to Section 108(a)(1), what otherwise would constitute COD income is not taxable as such when the discharge of debt occurs "in a Title 11 case" or when the taxpayer is "insolvent" (this exclusion from gross income is mandated by statute and is not elective). A debtor will qualify under the Title 11 bankruptcy exception only if he is under the jurisdiction of the bankruptcy court and the discharge either is granted by the court or occurs pursuant to a plan approved by the court. [FN5] The insolvency exception, on the other hand, generally applies to taxpayers whose liabilities exceed the fair market value of their assets.

A taxpayer's insolvency is determined with reference to his assets and liabilities immediately before the discharge of debt occurs. [FN6] The jurisprudence indicates that assets such as going concern value and goodwill should be considered when determining whether and to what extent a taxpayer is insolvent. [FN7] Assets exempt from the claims of creditors should not be included in the determination, however, [FN8] nor should the assets of a spouse be taken into account when determining the insolvency of the other spouse. [FN9] All of the taxpayer's liabilities should be taken into consideration when applying the insolvency test and, although it is unclear whether contingent liabilities are to be considered, such liabilities were included in the equation in at least one case under the judicially developed exception which later was codified as part of Section 108. [FN10]

The bankruptcy exception takes precedence over the insolvency exception where both otherwise would apply. [FN11] This coordination of the two exclusionary provisions is significant because, while the bankruptcy exception operates to exclude from gross income all of the income which otherwise would be recognized from the cancellation of debt, the amount of COD income so excluded is limited under the insolvency exception. The insolvency exception excludes COD income only to the extent the taxpayer was insolvent immediately before the discharge. [FN12] A taxpayer therefore will be subject to tax on COD income to the extent the discharge of debt renders him solvent. The ordering rules established by the Code with respect to these exclusions thus broaden the Section 108 exception to the benefit of taxpayers who satisfy both the bankruptcy and insolvency tests.

Example

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 180

Assume that T has total liabilities of $1,000, of which he owes $500 to C. If T has total assets with a fair market value of $800, he is insolvent to the extent of $200. If T transfers assets with a fair market value and basis of $200 to C in full satisfaction of his debt, he would be rendered solvent to the extent of $100 and, in the absence of Section 108, would be required to recognize $300 of COD income for tax purposes. Even under Section 108, T would be able to exclude COD income under the insolvency exception only to the extent he was insolvent before the discharge ($200), and would be required to recognize the balance of this COD income ($100) (which amount represents the extent to which the discharge renders the debtor solvent, and its inclusion is consistent with the "freeing up of assets" theory underlying the jurisprudential development of the COD income doctrine). If, however, T is insolvent and is under the jurisdiction of the bankruptcy court, under whose order the discharge occurs, the Section 108 ordering rules will invoke the bankruptcy exception and thereby prevent him from having to recognize any of the COD income.

Although COD income is not taxable to the extent a debtor qualifies for either the bankruptcy or insolvency exception provided under Section 108, the exclusion of COD income under those exceptions does not come without a price. The amount so excluded must be applied to reduce certain of the debtor's tax attributes. [FN13] Thus, while the debtor is not required to pay taxes currently as a result of the discharge, he must forego tax benefits which otherwise would flow in the future from tax attributes which he possesses at the end of the year in which the discharge occurs (such as depreciation deductions with respect to depreciable property and various loss or credit carryovers). The taxpayer has the option of electing first to reduce his remaining basis in depreciable property [FN14] or of reducing his tax attributes in the following order:

Any net operating loss (NOL) for the year of the discharge and any NOL carryover to that year;

Any carryover to or from the year of the discharge of an amount representing certain allowable general business credits;

Any net capital loss for the year of the discharge and any such loss carryover to that year;

The basis of certain property held by the taxpayer on the first day of the taxable year following the year of the discharge; and

Any foreign credit carryover to or from the year of the discharge. [FN15]

The reduction in tax attributes is to be made after the determination of tax for the year of the discharge. [FN16] This ordering rule enables taxpayers to obtain the full benefit of their existing tax attributes otherwise available for the year in which the debt is discharged. The reduction of tax attributes is made on a dollar-for-dollar basis, except with respect to credit carryovers, of which 33 1/3 cents are reduced for each dollar of COD income excluded under Section 108(a). [FN17] Any amount of COD income remaining after being applied to reduce the taxpayer's various tax attributes is simply excluded from income under the general exclusion set forth in Section 108(a)(1).

Qualified Farm Indebtedness

In addition to the Title 11 and insolvency exceptions, the Code provides an exception to the recognition of COD income with respect to "qualified farm indebtedness." [FN18] The availability of this exception does not depend upon the debtor being insolvent or in bankruptcy. If the debt is cancelled while the taxpayer in fact is insolvent, the insolvency exception will apply in lieu of the more limited exception for qualified farm indebtedness, however. [FN19] Further, if the discharge occurs while the taxpayer is in bankruptcy, he will be entitled to the broader benefits available under the bankruptcy exception. [FN20]

The qualified farm indebtedness exception is available only with respect to the cancellation of a debt by a creditor who is not related to the taxpayer [FN21] and who is regularly engaged in the business of lending money. [FN22] Further, the cancelled debt qualifies for the exclusion only if it was incurred directly in connection with

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 181

the business of farming. [FN23] Finally, only taxpayers with gross receipts from the three prior years at least 50 percent of which are attributable to the trade or business of farming may avail themselves of the exclusion. [FN24] The exclusion of COD income with respect to qualified farm indebtedness comes at the same price as the exclusion provided for discharges of debt in Title 11 cases or when the taxpayer is insolvent: the taxpayer is required to reduce certain of his tax attributes. [FN25] In contrast with the Title 11 and insolvency exceptions, however, the qualified farm indebtedness exception applies only to the extent the taxpayer has tax attributes available for reduction; any COD income remaining after reduction of those tax attributes must be recognized as taxable income. [FN26]

Student Loans

Certain student loans may be cancelled without any income tax consequences to the debtor. The exclusion applies to loans made by certain creditors (governmental agencies and certain health or educational organizations) which, under their terms, are cancelled because the debtor fulfilled an obligation to work for a specified period of time in a designated profession. [FN27]

Exceptions to COD Income Treatment

In addition to the specific statutory exclusions from COD income recognition discussed above, Section 108 sets forth a number of other exceptions to the general rule that gross income includes income from the cancellation of debt. [FN28] Rather than simply excluding COD income from recognition, these provisions preclude the initial characterization of certain items as COD income. Some of these statutory exceptions are derived from a long line of jurisprudence, under which they still may find sanction even when the technical requirements for their application are not satisfied. These exceptions to COD income realization are summarized below.

Lost Deductions

First, the Code provides that COD income will not be realized to the extent the debtor would have been entitled to a deduction had he paid the discharged debt. [FN29] For example, a cash basis taxpayer who is discharged from a liability to pay for office supplies which he received and consumed would not be treated as having realized COD income because he would have been entitled to a deduction had he paid the debt. This benefit would not flow to an accrual basis taxpayer, however, who presumably would have claimed a deduction when the supplies were delivered or used.

Purchase Price Reductions

The second exception involves the reduction of a debt due to the seller of property while the debtor is solvent (this exclusion does not apply either in a Title 11 case or while the debtor is insolvent). The courts historically treated such reductions as adjustments to the purchase price of the property, and the Code follows suit. [FN30] The legislative history indicates that the statutory provision does not apply, however, either where the buyer has transferred the property or where the seller has transferred the debt. [FN31] The original judicially created exception may be available even when the statutory exception is not, however. [FN32]

Contributions to Capital

The Code also excepts from treatment as COD income any acquisition by a corporation of its own debt from a shareholder as a contribution to capital. [FN33] This exception applies in cases where the corporation does not issue additional stock in satisfaction of the debt. In such cases, the corporation is treated as having satisfied its obligation with an amount of money equal to the shareholder's basis in the debt. Whether or not the corporation will realize COD income as a result of the discharge thus depends upon whether the forgiving shareholder employs the cash or accrual method of accounting for tax purposes. In either case, the shareholder generally will have a basis in the debt at least equal to its principal amount. The corporation's potential for realizing COD income as a result of the discharge therefore exists only with respect to the interest element of the obligation.

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 182

Subject to possible exclusion under other exceptions provided by Section 108 of the Code, COD income will arise with respect to accrued but unpaid interest where the shareholder-creditor employs the cash method of accounting. This is so because a cash basis creditor will not have included as taxable income the accrued but unpaid interest and, accordingly, will have no tax basis in that amount. Since the contribution to capital exception treats the corporation as having satisfied the obligation with an amount of money equal to the shareholder's basis in the debt, any part of the forgiven obligation in excess of that amount (interest) will be treated as COD income under the general rule (if a cash basis corporation would have been entitled to a deduction had it paid the interest, however, the realization of COD income arguably would be avoided under the lost deduction theory discussed above). This potential does not exist with respect to accrual basis shareholders, however, since under their method of accounting their basis in the debt will include the accrued but unpaid interest.

Stock for Debt

The Code also provides an exception to COD income realization in cases where a corporate debtor transfers its stock in satisfaction of a debt. [FN34] In such cases, the corporation is deemed to have sold the stock at its fair market value and used the cash from the sale to satisfy the debt. The corporation therefore will realize COD income only to the extent the amount of the debt exceeds the fair market value of the stock given in the exchange. The statutory stock-for-debt exception does not apply if the debtor-corporation is in a Title 11 case or if the exchange occurs while the corporation is insolvent. [FN35] In that event, the corporation may avail itself of the general exclusion provided by Section 108(a) (subject, of course, to the requirement under Section 108(b) that certain tax attributes be reduced--it is arguable that a bankrupt or insolvent corporation which satisfies the judicially developed stock-for-debt exception may avoid the initial realization of COD income, thereby falling outside the Code treatment of such income and escaping the attribute reduction otherwise called for under the statutory exception). [FN36]

New Debt Instruments

Finally, in a vein similar to the statutory stock-for-debt exception, the Code provides that a debtor who issues a debt instrument in satisfaction of an existing obligation will be treated as having satisfied the debt with an amount of money equal to the issue price of the new instrument. [FN37] In essence, the issue price represents the principal amount of the new obligation as determined under the original issue discount rules of the Code. [FN38] Any excess amount of the existing debt over the issue price of the new debt will be treated as COD income, subject to possible exclusion under the other exceptions set forth in Section 108.

Conclusion

Because of the potentially severe income tax consequences which may attend the cancellation of debt, practitioners should keep the tax aspect of any debt restructuring in mind when helping debtors obtain relief from financial hardship. It is important to consider both the form in which a debt discharge is cast and (because of the statutory insolvency and bankruptcy exceptions to COD income recognition) the timing of the transaction. Finally, the Code and regulations set forth a variety of technical details which are beyond the scope of this article but which may affect taxpayers differently depending upon their individual financial and tax situations. Practitioners therefore should consult with their client's tax adviser before concluding any rearrangement of debt.

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FN1. There are both judicial and statutory exceptions to the general rule where the debtor gives his note in exchange for property other than cash; these exceptions will be discussed below.

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FN2. For this reason, the forgiveness of a guarantor's secondary obligation to pay a liability with respect to which the primary debtor has defaulted does not give rise to COD income on the part of the guarantor. Since the guarantor did not receive any of the loan proceeds, he realized no traceable increase in assets arising out of the loan. See Hunt v. Comm'r, 57 TCM 919 (1989), PLR 9105042 and Bradford v. Comm'r, 233 F.2d 935 (6th Cir.1956). Nor does COD income result from the compromise of a contingent obligation. Such an "obligation" does not represent an indebtedness until the necessary condition occurs and produces neither a traceable increase in assets nor a tax benefit.

FN3. Danenberg v. Comm'r, 73 TC 370 (1979). This analysis comports with Treas.Reg. § 1.1001-2(a)(2), which provides that the amount realized on the sale or exchange of property subject to a recourse liability does not include COD income. See also Treas.Reg. § 1.1001-2(c) (ex. 8) and Rev.Rul. 90-16, 1990-1 C.B. 12.

FN4. Treas.Reg. § 1.1001-2(a)(1) provides that, except as provided in Paragraphs (2) and (3) thereof, the amount realized from the sale or other disposition of property includes the amount of liabilities from which the transferor is discharged as a result of the exchange. Although Paragraph (2) of this regulation excludes COD income from the amount realized in a recourse setting, no such exclusion is provided in the case of nonrecourse debt. See Comm'r v. Lufts, 461 U.S. 300, 103 S.Ct. 1826, 75 L.Ed.2d 863 (1983); Treas.Reg. § 1.1001-2(c)(2) (ex. 7); and Rev.Rul. 76-111, 1976-1 C.B. 214.

FN5. IRC Section 108(a)(1)(A) and (d)(2).

FN6. IRC Section 108(d)(3). The determination of insolvency of either a C or S corporation is made at the corporate level without regard to the assets and liabilities of the shareholders. The determination is made at the partner level with respect to the excludability of COD income realized by a partnership, however. See IRC Section 108(d)(6) and (7).

FN7. Conestoga Transportation Co. v. Comm'r, 17 TC 506 (1951); J.A. Maurer, Inc. v. Comm'r, 30 TC 1273 (1958). On the other hand, the tax court did not include as assets the value of an individual taxpayer's business expertise and business relationships. See Davis v. Comm'r, 69 TC 814 (1978).

FN8. Davis, supra at n. 7; Cole v. Comm'r, 42 BTA 1110 (1940); Estate of Marcus v. Comm'r, 34 TCM 38 (1975); Hunt v. Comm'r, supra at n. 2; PLR 9130005; PLR 9125010.

FN9. PLR 8920019.

FN10. Conestoga Transportation Co., supra at n. 7.

FN11. IRC Section 108(a)(2).

FN12. IRC Sections 108(a)(3) and (d)(3).

FN13. IRC Section 108(b)(1).

FN14. IRC Section 108(b)(5).

FN15. IRC Sections 108(b)(2) and 1017.

FN16. IRC Section 108(b)(4)(A).

FN17. IRC Section 108(b)(3).

FN18. IRC Section 108(a)(1)(C).

FN19. IRC Section 108(a)(2)(B).

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 184

FN20. IRC Section 108(a)(2)(A).

FN21. Within the meaning of IRC Section 465(b)(3)(C).

FN22. IRC Section 108(g)(1)(B).

FN23. IRC Section 108(g)(2)(A).

FN24. IRC Section 108(g)(2)(B).

FN25. IRC Section 108(b)(1).

FN26. IRC Section 108(g)(3).

FN27. IRC Section 108(f).

FN28. Since these exceptions prevent the initial treatment of certain debt cancellations as giving rise to COD income, it is not necessary to look to any other provision of the Code for exclusion of those amounts.

FN29. IRC Section 108(e)(2).

FN30. IRC Section 108(e)(5).

FN31. S.Rep. No. 1035, 96th Cong., 2d Sess. 16 (1980); H.Rep. No. 833, 96th Cong., 2d Sess. 13 (1980).

FN32. S.Rep. No. 1035, 96th Cong., 2d Sess. 20, n. 24 (1980) indicates that the original jurisprudential exception remains alive.

FN33. IRC Section 108(e)(6).

FN34. IRC Section 108(e)(10).

FN35. Section 108(e)(10)(B). The exception also does not apply to exchanges after Oct. 9, 1990 which involve certain redeemable stock. Id.

FN36. Since IRC Section 108(e)(10)(B) precludes application of the statutory stock-for-debt exception in cases where the debtor corporation is in a Title 11 case or is insolvent, the original judicially developed exception may apply to such corporations.

FN37. IRC Section 108(e)(11).

FN38. IRC Section 108(e)(11)(B).

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DATE OF REQUEST: 05/11/95
THE CURRENT DATABASE IS BLRLR

Baylor Law Review

Spring, 1989

*231 THE DISPOSITION OF PROPERTIES SECURED BY RECOURSE AND NONRECOURSE DEBT

William J. Rohrbach, Jr. [FNa]

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Introduction

I. PRIOR TO CRANE V. COMMISSIONER

II. CRANE V. COMMISSIONER

III. COMMISSIONER V. TUFTS

IV. VOLUNTARY AND INVOLUNTARY SALES

V. THE AMOUNT REALIZED OR SALES PRICE

VI. ABANDONMENT V. SALE OR EXCHANGE

VII. YEAR OF INCLUSION

VIII. TREASURY REGULATION § 1.1001-2(a)(2) - DISCHARGE OF INDEBTEDNESS

IX. AFTER REGULATION § 1.1001-2(a)(2)

X. DEBT FORGIVENESS

XI. AMOUNT REALIZED AND ACCRUED INTEREST

XII. SECTION 108

XIII. SECTION 1017

XIV. RECAPTURE OF DEPRECIATION

XV. PURCHASE PRICE ADJUSTMENTS

XVI. SUMMARY

Conclusion

INTRODUCTION

A discussion of sales and exchanges of property secured by recourse and nonrecourse debt brings to mind a court's finding of an "optimist's valhalla,"' "'miraculous dreams of a rising phoenix"' and "sophisticated tax legerdemain."' [FN1] The tax consequences inherent in the use of recourse and nonrecourse debt were unsure,

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became ***232** established and are now mixed. This paper will review the tax treatment of the disposition of property which is financed by recourse and nonrecourse financing. The discussion will be mostly chronological and an attempt will be made to discern the tax policy presented by the varying treatment. Examples will be used to demonstratively show the results of the evolution of the tax treatment.

I. PRIOR TO CRANE V. COMMISSIONER

If a taxpayer sold property that was encumbered by a recourse debt, the amount realized or the sales price the taxpayer received was the amount of money received plus the fair market value of property other than money received. [FN2] If the recourse debt was paid, it was considered that the taxpayer received that amount as money. If the recourse debt was assumed by the buyer, it was deemed that such assumption was the equivalent of the receipt of money by the taxpayer equal to the amount of the liability so assumed. [FN3]

Since it was properly assumed that no purchasers would pay more than fair market value for an asset, the note assumed or paid plus any other money and other property received equaled the property's fair market value. The amount of gain was then determined by deducting the adjusted basis of the property [FN4] from the amount realized. This is illustrated as follows (Example 1):

Note	100,000
Fair Market Value	110,000
Sales Price (10,000 + note)	110,000
Adjusted Basis	90,000
Gain/(Loss)	20,000

The tax policy surrounding such treatment appeared sound. The taxpayer, being personally liable on the note, either received the cash to pay the note and thus received money or the note was assumed and the taxpayer was relieved of payment, a situation equal to receipt of money. The amount realized by the taxpayer must include the amount he received and this includes the extinguishment of the obligation he was required by law to pay.

A taxpayer does not have a legal requirement to pay a nonrecourse debt. The lender may look solely to the collateral for satisfaction of the obligation. Upon a sale of property and payment by ***233** the purchaser of money or other property to the seller equal to the nonrecourse debt, a seller would have an amount realized equal to the consideration, and tax treatment similar to that of recourse debt would ensue. Confusion arose when the property was sold subject to the nonrecourse debt. It was argued that a taxpayer that was never personally liable on the nonrecourse debt could not and did not receive any benefit or consideration as regards the nonrecourse debt upon a sale that was subject to the debt. [FN5] It was further argued that the basis of such property did not include the nonrecourse debt and upon a sale subject to nonrecourse financing a taxpayer could only sell a "merely equity."' [FN6] Since a taxpayer had no personal obligation to pay the debt it was reasoned that, when the property was sold subject to the debt only, other consideration received would be calculated in the amount realized from a sale. [FN7] In fact, it was determined to be erroneous for the Commissioner to include the amount of a nonrecourse mortgage in the amount realized for a sale. [FN8] The tax consequences of a sale subject to nonrecourse debt, prior to 1947, are illustrated in Example 2:

Note (nonrecourse)	100,000
Fair Market Value	110,000
Sales Price (10,000 cash)	10,000
Adjusted Basis	0
Gain/(Loss)	10,000

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The fair market value of the property is irrelevant to the calculation except that it shows what the property would sell for on an all-cash transaction. The tax policy at this time was simply that a nonrecourse debt was entirely different from a recourse debt. A nonrecourse debt did not give basis, and conveyance of the property subject to the debt was not a factor in the amount realized. Since the taxpayer had no liability for payment of the debt, it was disregarded in all calculations. While this certainly resulted in different tax treatment in the use of recourse and nonrecourse debt (see Examples 1 and 2), such a bifurcated approach fully recognized that there indeed exists a real difference between personal liability obligations and ones from which a taxpayer may walk away with impunity. Since nonrecourse debt is not calculated in the basis of an asset, the amount of depreciation a taxpayer may take is limited to ***234** the amount of money or other property with which he actually parted. This policy, in fact, seems sound in light of subsequent legislation to limit basis to debt upon which the taxpayer is personally liable. [FN9]

II. CRANE V. COMMISSIONER

In Crane v. Commissioner, [FN10] the taxpayer sold a mortgaged apartment building, which she had inherited, to a third party. She received $3,000 in cash and the buyer agreed to take the property subject to the mortgage. The property had previously been appraised for estate tax purposes at about one-quarter million dollars. [FN11] Mrs. Crane had taken $28,045.10 depreciation on the building. [FN12] Mrs. Crane asserted she had a taxable gain of $2,500 calculated by deducting $500 sales expense from $3,000 received and claiming a zero basis. The IRS asserted Mrs. Crane had a taxable gain of $24,031.45. [FN13]

The Supreme Court determined that Mrs. Crane inherited not the equity but the property's full value. [FN14] The Court then addressed the issue of the amount realized from the sale. First, the Court said, it would be an "absurdity"' to believe that Mrs. Crane sold property valued at $250,000 for only $3,000 in cash unless she sold only the equity and, secondly, that Mrs. Crane was benefited by being relieved from the mortgage. [FN15] The Court noted that such a principle was well established as to recourse debt, [FN16] and made the rule equally applicable to nonrecourse debt having an unpaid balance less than the value of the property:

> [A]n owner of property, mortgaged at a figure less than that at which the property will sell, must and will treat the conditions of the mortgage exactly as if they were his personal obligations. If he transfers subject to the mortgage, the benefit to him is as real and substantial as if the mortgage ***235** were discharged, or as if a personal debt in an equal amount had been assumed by another. [FN17]

The nonrecourse debt is now to be calculated in all respects as if it were a recourse debt. This may be illustrated as follows (Example 3):

	Recourse Debt	Nonrecourse Debt
Note	100,000	100,000
Fair Market Value	110,000	110,000
Sales Price (deemed amount realized)	110,000	110,000
Adjusted Basis	90,000	90,000
Gain/(Loss)	20,000	20,000

The Supreme Court determined that, as a matter of tax policy, the taxpayer owns the entire property, not just the equity, when the property is encumbered by nonrecourse debt. Therefore, the taxpayer owes the whole debt. Likewise, it was determined that upon sale of property encumbered by nonrecourse debt, a taxpayer transfers the entire value of the property and receives release from the whole debt. [FN18] The decision was not unanimous by far. Mr. Justice Jackson, joined by Mr. Justice Frankfurter and Mr. Justice Douglas, would have affirmed the tax

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court. [FN19] They reasoned, as had the tax court, that the taxpayer never became personally liable for the debt, and when the asset was sold subject to the debt the taxpayer was released from no debt. [FN20] The dissent concluded that the debt was simply a subtraction from the value of what she did receive and from what she sold, and this left the taxpayer only the cash she actually received when she sold the property. [FN21] The decision in Crane now allowed a taxpayer to obtain basis in property that would include the debt secured by the property, be it recourse or nonrecourse debt.

While equal treatment of recourse and nonrecourse debt when the sales price (and thus fair market value) is greater than the amount of the debt was mandated by the Court, it was less definitive in the tax treatment afforded upon a disposition of property securing nonrecourse debt when the property's fair market value (thus sales price) is less than the debt. In the now-famous footnote 37, the Court pondered:

> ***236** Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgage. Consequently, a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage without receiving boot. This is not this case (emphasis added). [FN22]

After a pronouncement of the obvious, taxpayers argued that the benefit and amount realized from disposition of property with a fair market value was limited to the property's fair market value. [FN23] Quite as obviously, the Service took the opposite view. [FN24] The post-Crane footnote 37 treatment taken by taxpayers is illustrated as follows (Example 4):

	Recourse Debt	Nonrecourse Debt
Note	100,000	100,000
Fair Market Value	75,000	75,000
Sales Price (deemed amount realized)	100,000	75,000
Adjusted Basis	90,000	90,000
Gain/(Loss)	10,000	(15,000)

The tax policy hereby recognized is that without personal liability the amount realized upon a sale cannot exceed the value of the property when nonrecourse debt is involved, but the amount realized can exceed the value of the property when recourse debt is secured by the property. While this makes some sense, it would seem that either nonrecourse debt should be fully counted in the amount realized or it should be totally disregarded, as was the policy prior to Crane.

III. COMMISSIONER V. TUFTS

Footnote 37 was finally and squarely raised in Commissioner v. Tufts. [FN25] In Tufts, the property had a value substantially less than the nonrecourse mortgage. The partnership financed an apartment house with a nonrecourse loan, the rental market declined, and the partners sold their interest subject to the debt and $250 in cash. [FN26] ***237** The partners limited the amount they claimed as realized to the fair market value of the property and thereby claimed a loss. [FN27] The Service, on audit, determined the sale resulted in a partnership capital gain of approximately $400,000. [FN28]

The Court read Crane "to have approved the Commissioner's decision to treat a nonrecourse mortgage in this context as a true loan."' [FN29] The Commissioner had been on record in his position that the excess of nonrecourse indebtedness cancelled over the adjusted basis of the asset transferred, or the excess of the adjusted basis over the nonrecourse indebtedness cancelled, represents gain or loss from the sale of assets under section 1001 of the 1958 Code. [FN30] The Commissioner had decided to afford nonrecourse indebtedness the same

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treatment as he gives a recourse mortgage. [FN31]

The Commissioner also had chosen not to characterize the transaction as a cancellation of indebtedness. [FN32] It is important to note at this juncture that the IRS had issued Treasury Regulation § 1.1001-2 (Discharge of Liabilities) shortly before this decision. [FN33] The Court expressly withheld opinion or dictum regarding the issues of debt forgiveness. [FN34] The Court did, however, state:

> In the context of a sale or disposition of property under § 1001, the extinguishment of the obligation to repay is not ordinary income; instead, the amount of the canceled debt is included in the amount realized, and enters into the computation of gain or loss on the disposition of property. According to Crane this treatment is no different when the obligation is nonrecourse. [FN35]

Up to this point, one may almost believe that clarity reigns and that "one of the murkiest pools of obscurity in the tax law for the past three decades"' [FN36] has become spring fed. By edict from the high nine on the Potomac, nonrecourse and recourse indebtedness ***238** will be treated similarly upon the sale or disposition, and gain or loss will be then easily determined under section 1001 of the Code. Tufts treatment can be analyzed by the following example and, when compared to Example 4, the distinction is apparent (Example 5):

	Recourse Debt	Nonrecourse Debt
Note	100,000	100,000
Fair Market Value	75,000	75,000
Sales Price (deemed amount realized)	100,000	100,000
Adjusted Basis	90,000	90,000
Gain/(Loss)	10,000	10,000

The Tufts decision further established that nonrecourse debt will have all the tax attributes of recourse debt. The fact that recourse and nonrecourse debt are treated significantly differently to all but the taxman is irrelevant and the pre-Crane position of the tax court is fully and completely buried.

IV. VOLUNTARY AND INVOLUNTARY SALES

That a sale is voluntary or forced (foreclosure) does not result in different treatment. [FN37] The term "sale"' may have many meanings depending on the context. [FN38] The Supreme Court stated that they could find no basis in the language of the Act, its purpose or legislative history for saying that losses from sales of capital assets were to be treated any differently whether they result from forced sales or voluntary sales. [FN39] It is the sale, be it voluntary or forced, which finally cuts off the interest of the mortgagor and is the means for determining the amount of deficiency judgment against him and is a means adopted by statute for determining the amount of his capital gain or loss from the sale of the mortgaged property. [FN40]

V. THE AMOUNT REALIZED OR SALES PRICE

Before we explore how the IRS can turn a capital transaction into one generating ordinary income in some instances, we will look at what the sales price really is. Obviously, in a voluntary sale, determination of the sales price, absent chicanery, is not difficult. I will limit this part of the discussion to an involuntary sale of real estate. ***239** I will avoid discussion of depreciation recapture, ITC recapture, and the like.

We do not, immediately, need to differentiate between recourse and nonrecourse indebtedness since real estate is excepted from the at-risk requirements. [FN41] Further, whether or not the mortgagor filed for protection under the Bankruptcy Act or whether the mortgagor is solvent, is not in issue as to the amount realized. One way

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or another, a trustee's sale is held on the first Tuesday of a month and the mortgagor's property is struck off to a third party or to the debt holder. [FN42] The amount received or credited at the trustee's sale will be the sales price and amount realized by the mortgagor. But what if that amount is not the fair market value of the property on the date of sale? A secured party has a fiduciary duty to sell the collateral at the highest possible price, but as a purchaser his interest is to buy the collateral at the lowest price. [FN43] Prior to 1986, the rule in Texas was that a trustee, while having a fiduciary duty to the debtor, could sell or bid on the collateral as long as the price was not grossly inadequate. [FN44] In 1980 the Fifth Circuit decided the Durrett case. [FN45] Durrett was a debtor in possession under Chapter XI of the Bankruptcy Act and sought to set aside and vacate a transfer of real property that was foreclosed on by the insurance company nine days before he filed for protection. Durrett's sole issue on appeal was whether a fair equivalent had been paid at the foreclosure sale. [FN46] The property was sold for 57.7% of its fair market value and the fifth circuit, in voiding the sale, could locate no district court or appellate court decision that dealt with a transfer of real property which had approved the transfer for less than 70% of the market value of the property. [FN47] Thus sprang up the Durrett Rule or the 70% Rule. Lenders embraced it as if it would absolutely apply to all foreclosures. This belief was strengthened in 1985 by the Willis decision ***240** in the Southern District of Texas. [FN48] Mr. Willis voided the involuntary sale of his residence. The court looked at four different methodologies in determining what percentage of the fair market value the sales price was. The methodologies resulted in 73%, 18%, 41% and 20% as possible percentages. The court rejected the 73% test, did not decide which of the remaining three methods was correct, and voided the sale. [FN49]

A debtor in bankruptcy could litigate the sales price determined at foreclosure based on these rules. A state court action was still controlled by the grossly inadequate sales price standard of Maxey. [FN50]

In 1986, the Beaumont Court of Appeals decided Sabine Bank. [FN51] While the case dealt with the foreclosure upon and sale of personalty, the court used the case to write upon the law of foreclosure, be it of personalty or realty. The court reasoned that:

> A lender who has secured collateral, whether personalty or realty is under a trust arrangement with the borrower, in the event of foreclosure, to make an honest effort to reduce the loan as much as possible by securing a fair price for the collateral. [FN52]

Noting that the Texas Supreme Court had never spoken precisely on the subject, [FN53] the court held that a borrower may contest the sale if a significant disparity exists between the sales price and the property's fair market value. [FN54] The reasoning of the court is in line with other jurisdictions that have reviewed the issue. [FN55]

Now a taxpayer can at least litigate the sales price that the lender will report to the IRS. A taxpayer may now determine his basis in the real estate that was foreclosed on, accept, negotiate or seek legal recourse of the sales price, go to section 1001 of the Code and determine the amount and recognition of his gain or loss.

***241** A distinction between recourse and nonrecourse financing must now be made. If the property secured nonrecourse financing, Crane and Tufts control, and the fair market value of the property is not in issue when the property has a value less than the debt owed. If, however, the financing was recourse, the determination of the sales price becomes critical.

VI. ABANDONMENT VS. SALE OR EXCHANGE

A related issue is the nature of any gain or loss upon an abandonment of property secured by nonrecourse financing. In 1980 the tax court decided Freeland. [FN56] Freeland had purchased real estate for $50,000, put $9,000 cash down and gave the seller a $41,000 note secured by a deed of trust on the property. [FN57] Under the terms of California law, a seller who owner-financed the sale of his property could not seek a deficiency judgment against a purchaser, thus making the note nonrecourse in nature. [FN58] The market value of the property was reduced to $27,000 and Freeland quitclaimed the property back to the seller when the balance of the

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note was still $41,000. [FN59] Freeland claimed an ordinary loss of $9,188 ($188 sales expense) on his tax return for the year in which he abandoned the property back to the seller by quitclaim deed. [FN60] The amount of the loss was not in dispute, but the Service determined that the loss was deductible only as a loss on the sale or exchange of a capital asset subject to the limitations provided in sections 1211 and 1212. [FN61] The parties framed the issue in terms of abandonment, and both parties implicitly agreed that a loss sustained on abandonment is an ordinary one. [FN62] Freeland stated that the issue to be decided is whether a disposition by abandonment constitutes a sale or exchange. [FN63] The Commissioner, while conceding that abandonment of property is not a disposition by sale or exchange, argued that this disposition was the equivalent of a foreclosure sale rather than an abandonment. ***242** [FN64] The court determined that by reconveying the property to the seller. Freeland had accomplished an abandonment under California law. [FN65] "That a disposition, causing gain or loss to be recognized under § 1001 occurs upon a reconveyance of property in satisfaction of a mortgage obligation is well settled."' [FN66] However, not every taxable disposition of property is a sale or exchange. [FN67] The court looked at five factors that were given consideration in other decisions, namely:

(1) whether the transfer was voluntary or involuntary,

(2) whether the mortgage debt was released or not, and whether the transferor received an additional (even minimal) consideration or boot,

(3) whether the transferor-mortgagor was personally liable on the mortgage debt,

(4) whether the transferor-mortgagor received any tax benefits from including the mortgage debt in his basis while he held the property, and

(5) whether the fair market value of the property at the time of reconveyance exceeded or was less than the unpaid balance due on the mortgage debt. [FN68]

The court then analyzed what the result would be if the mortgage was recourse. "'It has been well established that where a taxpayer transfers property to his mortgagee in [satisfaction] of a mortgage obligation for which he is personally liable, any loss sustained by him will be deemed to have resulted from a sale or exchange on the ground that the taxpayer received consideration in return for transferring this property, the consideration being his release from liability."' [FN69] It is important to note that the court, in restating the law as it applied to recourse financing, did not apparently include the concept of debt forgiveness resulting from a reconveyance when the fair market value of the property is less than the outstanding principal balance of the mortgage.

The court reviewed the decision in Hammel wherein the Supreme Court concluded that a foreclosure sale (or involuntary sale) constituted ***243** a sale or exchange resulting in a capital loss, [FN70] a reviewed Crane [FN71] and later decisions and decided that they believed that the holdings of Crane, and subsequent cases decided in light of Crane, mandate the conclusion that relief from indebtedness, even though there is no personal liability, is sufficient to support a sale or exchange. [FN72]

In 1984 the fifth circuit decided a case directly on point with Freeland. [FN73] In Yarbro v. Commissioner, the taxpayer formed a joint venture that purchased unimproved real estate. [FN74] The purchase price was $362,132.08; approximately 10% was paid in cash as a down payment and the balance was represented by four nonrecourse promissory notes secured by deeds of trust on the property. The property was subject to a grazing lease and the joint venture continued to rent the property for grazing during its ownership period. Due to an increase in property taxes and decline in the value of the property, the joint venture decided to abandon the property. [FN75] Unlike Freeland, the taxpayer notified the lending institution that he was abandoning the property, would not pay the taxes due on it and would not deed it back in lieu of foreclosure, stating that he "had nothing to convey and would have nothing to do . . . with the property from that point on."' [FN76] The bank subsequently foreclosed on the property.

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The taxpayer claimed an ordinary loss of approximately $10,000. [FN77] The Commissioner took the position that the taxpayer's abandonment of the property constituted a sale or exchange within the meaning of sections 1211 and 1212 of the Code. The Commissioner further determined that the taxpayer held the land as an investment and not for use in his trade or business, and concluded that the abandonment was the sale or exchange of a capital asset. [FN78]

The tax court agreed with the Commissioner and, relying on Freeland, held that an abandonment of property constituted a sale or exchange for purposes of Code sections 1211 and 1212. [FN79] Further, ***244** the tax court relied on Middleton v. Commissioner, a case which was very similar in material aspects to the instant case. [FN80]

The fifth circuit held the question to be whether a taxpayer can avoid the tax consequences of Hammel by the simple expedient of abandoning the property before the mortgagee can foreclose and stated: "The Freeland court saw no reason, nor do we, to put such a premium on artful timing."' [FN81]

Thus a foreclosure, deed in lieu of foreclosure or simple abandonment of real property secured by a nonrecourse mortgage, will be treated as a sale or exchange and, if held for investment, will create capital gains and losses. If an asset is transferred, the amount realized from disposition is first offset by the adjusted basis of the transferred property in order to determine the transferor's gain or loss from the transaction. [FN82] Qualifying gains or losses [FN83] are subject to the capital gain and loss rules which provide for more stringent limitations on deductibility in the case of a net loss for the year. [FN84] The courts seem to have erased all distinctions between the use of recourse and nonrecourse debt upon the sale or exchange of the asset.

VII. YEAR OF INCLUSION

Assuming a foreclosure or abandonment of property secured by recourse debt and assuming the lender declares a deficiency, which year does the taxpayer take into account in determining his loss and/or income from any debt forgiveness? Ordinarily the taxpayer would account for the transaction on his tax return in the year of foreclosure or abandonment. This is the transaction approach. [FN85] However, if the taxpayer challenges the amount determined by the lender as not being the fair market value, the event could take place in one year and the amounts be determined in a later year. Further, as to any debt forgiveness, the lender has four years from date of default to bring a deficiency action. [FN86] Until the statute of limitations ***245** has run or other indicia of forgiveness is apparent, it would seem the taxpayer is free to choose the year of inclusion. [FN87] The taxpayer can elect a year that may be more beneficial from a tax standpoint than others. For instance, in the year of foreclosure the taxpayer may be solvent but in the next year other property declines in value and the taxpayer may now be insolvent in an amount equal to or greater than the claimed deficiency. In year two the taxpayer includes the income on his tax return and may exclude the income that the deficiency has generated. [FN88]

Upon the death of a taxpayer, if the decedent's executor does not intend to satisfy a debt of the decedent and it is apparent either due to the failure to file a claim or otherwise that the creditor is not going to seek to enforce the claim, the decedent's estate will realize debt forgiveness income. [FN89]

VIII. TREASURY REGULATION § 1.1001-2(A)(2) -- DISCHARGE OF INDEBTEDNESS

Up to this point, it would seem that the tax treatment on disposition of an asset encumbered by a recourse or nonrecourse debt will be treated similarly. The amount realized on sale or exchange includes the amount of the debt even if it is nonrecourse and the property has a fair market value less than the debt.

While Tufts pending before the Court of Appeals for the Fifth Circuit, the Treasury promulgated Regulation § 1.1001-2(b) which states that the fair market value of an asset at time of sale is not relevant for purposes of determining the amount realized nor the amount of liability from which a taxpayer is discharged. [FN90] Along with that section of the regulation, the Treasury promulgated Regulation § 1.1001-2(a)(2): "Discharge of

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indebtedness. The amount realized on a sale or other disposition of property that secures a recourse liability does not include amounts that are (or would be if ***246** realized and recognized) income from the discharge of indebtedness under § 61(a)(12) . . . ."' [FN91]

The Service was required by the Crane/Tufts reasoning to include the entire amount of the principal debt owed in the amount realized when the debt was nonrecourse. The lesson of these cases seemed to be one of equal treatment for recourse and nonrecourse debt. Now, however, the Service has bifurcated the treatment of recourse and nonrecourse debt when the fair market value of the asset is less than the amount owed. [FN92] Prior to the Treasury taking this approach, the courts had, as a rule, treated income realized by a debtor from the transfer of property in discharge of nonrecourse debt in the same manner as such income from recourse debt -- as gain from the sale of the transferred property. [FN93] Almost uniformly the taxable event has been characterized as a sale of the transferred property resulting in gain to the extent that the liability discharged exceeded the property's adjusted basis. [FN94] The same result was reached even in some cases in which the Service attempted to characterize the transaction as producing cancellation of indebtedness income. [FN95] The problem before Crane and Tufts was the treatment of nonrecourse indebtedness upon a sale or exchange (voluntary or involuntary), not how to treat a sale or exchange of property securing recourse debt. The tax consequences of the latter were well understood:

> If an owner sells property for more than its basis, the assumption that there has been a taxable gain follows almost inevitably. This is as true where the consideration received is property as where it is cash. Sometimes the transaction involves an atypical sort of consideration such as a release of the transferor's indebtedness. That does not prevent the transfer from being a sale or exchange resulting in capital gain or loss. So where an owner pledges his property for a loan, the proceeds of which are greater than his basis, and subsequently succeeds in transferring the property for ***247** a cancellation of debt, the excess of what is received over the basis of the property is gain, taxable in the year which the property is disposed of and the debt discharged. [FN96]

In each case the transaction is treated as if the mortgagor had sold the property for cash equivalent to the amount of the debt and had applied the cash to the payment of the debt. [FN97]

As stated above, Regulations § 1.1001-2(a)(2) was promulgated at the time the Supreme Court decided Tufts. A portion of the regulation was cited in the case. [FN98] Further, in discussing the issue that nonrecourse financing gave rise to most tax shelters and that Congress enacted at-risk rules but exempted real estate from them, the Court states in a footnote, "[a]lthough this congressional action may foreshadow a day when nonrecourse and recourse debts will be treated differently, neither Congress nor the Commissioner has sought to alter Crane's rule of including nonrecourse in both basis and amount realized."' [FN99] The Court goes on to state in another footnote:

> In the context of a sale or disposition of property under § 1001, the extinguishment of the obligation to repay is not ordinary income; instead, the amount of the cancelled debt is included in the amount realized, and enters into the computation of gain or loss on the disposition of the property. According to Crane, this treatment is no different when the obligation is nonrecourse: the basis is not reduced as in the cancellation of indebtedness context and the full value of the outstanding liability is included in the amount realized (emphasis added). [FN100]

To be sure, the Supreme Court could have decided Tufts differently. [FN101] Justice O'Connor, is her concurring opinion, indeed bemoaned the fact that she felt compelled to follow the teachings of Crane, "[i]ndeed, were we writing on a clean slate except for the ***248** Crane decision, I would take quite a different approach . . . ."' [FN102] The court did not take a different approach but affirmed the Crane reasoning. Does Regulation § 1.1001-2(a)(2) conflict with the Crane/Tufts decisions?

IX. AFTER REGULATION § 1.1001-2(a)(2)

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The Service has found no conflict and has applied the two-step analysis set forth in the regulation for treatment of recourse debt upon sale or exchange of the asset. To demonstrate the Treasury's approach to nonrecourse and recourse indebtedness upon a sale or exchange of an asset, the regulation includes two examples. First, nonrecourse debt:

> In 1974 E purchases a herd of cattle for breeding purposes. The purchase price is $20,000, consisting of $1,000 cash and a $19,000 note. E is not personally liable for repayment of the liability and the seller's only recourse in the event of default is to the herd. In 1977 E transfers the herb back to the original seller, thereby satisfying the indebtedness . . . . At the time of the transfer the fair market value of the herd is $15,000 and the remaining principal balance on the note is $19,000. At that time E's adjusted basis in the herb is $16,500 . . . . As a result of the indebtedness being satisfied, E's amount realized is $19,000 . . . . E's realized gain is $2,500 ($19,000-$16,500); [FN103]

Second, recourse debt:

> In 1980, F transfers to a creditor an asset with a fair market value of $6,000 and the creditor discharges $7,500 of indebtedness for which F is personally liable. The amount realized on the disposition of the asset is its fair market value ($6,000). In addition, F has income from the discharge of indebtedness of $1,500 ($7,500-$6,000). [FN104]

Since the promulgation of the regulation, the Service has been consistent in its application of the bifurcated or two-step approach upon a sale or exchange of an asset securing a recourse debt when the fair market value of the asset is less than the amount of the debt. Ordinary income will result from the cancellation of indebtedness. ***249** [FN105] Tax treatment after Regulation § 1.1001-2(b) may be further illustrated by the following example:

	Recourse Debt	Nonrecourse Debt
Note	100,000	100,000
Fair Market Value	75,000	75,000
Sales Price (deemed amount realized)	75,000	100,000
Adjusted Basis	90,000	90,000
Gain/(Loss)	(15,000)	10,000
Debt Forgiveness	25,000	

The changes in tax treatment are dramatic. The deemed amount realized is now the opposite of what would have been determined under post-Crane footnote 37 treatment. Other examples can show even greater disparity in tax treatment between disposition of property secured by recourse and nonrecourse financing. [FN106]

***250** The tax court has adopted the Commissioner's position. In Michaels v. Commissioners, [FN107] the court held that a discount that the taxpayer received on the prepayment of a recourse mortgage that was made in connection with the sale of her residence is not included in the amount realized for purposes of computing gain. The taxpayers included the discount as part of the gain they realized on the sale of their residence which they deferred. [FN108] The court in interpreting Regulation § 1.1001-2(a)(2) stated:

> This Regulation effectively bifurcates the instant transaction by removing the amount of the discount from the computation of the amount realized and recognizing it as a separate income item. [FN109]

While section 108 [FN110] allows a reduction in basis for the reduction of a debt held by the seller, no such allowance is made for reduction in a mortgage held by a third party.

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X. DEBT FORGIVENESS

Since a taxpayer may recognize debt forgiveness income, a determination of what is and is not such income is required. A taxpayer realizes and recognizes ordinary income if he is relieved of payment of a debt. [FN111] If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, the debtor realizes income in the amount of the debt as compensation. [FN112] A taxpayer does not realize income when money is borrowed due to the corresponding obligation to repay the amount borrowed. [FN113] If, however, the taxpayer is for some reason not required to repay the borrowed money income will result. In 1931, the U.S. Supreme Court held that if a corporation repurchases its own bonds for an amount less than the price for which it sold those bonds, the difference between the sale or issue price and the repurchase price constitutes taxable income to the corporation. [FN114] The Court based its ***251** decision on the theory that the reduction in outstanding liabilities (the difference between the issue and repurchase prices) resulted in a freeing of assets and an accession to income. [FN115]

This position is now statutorily embodied in section 61(a)(12) which states, "'[e]xcept as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items: . . . Income from discharge of indebtedness."' [FN116]

In order for a taxpayer to have income from discharge of indebtedness, there must in fact be a debt that is in some manner cancelled. There is no discharge of indebtedness income if there is no obligation to repay the funds that were advanced. In Millar v. Commissioner, [FN117] the taxpayers signed nonrecourse notes and invested the proceeds into the capital of a corporation they owned. Upon default the note holder foreclosed upon the taxpayers' stock in the corporation. The Commissioner took the position that the taxpayers had realized cancellation of indebtedness income on the surrender of their stock in the amount of their discharged nonrecourse obligation. [FN118] The issue as stated by the court was whether the taxpayers had an obligation to repay the funds advanced to them and if not then no cancellation of indebtedness could arise. Not surprisingly, one of the taxpayers took the position that the cash advances made to them were intended as gifts, not loans. [FN119] The court remanded for a factual determination of gift or loan, the tax court found a loan, [FN120] and that finding was affirmed on appeal. [FN121] Without a repayment obligation a transaction cannot be elevated to indebtedness and, therefore, cannot result in discharge of indebtedness income.

The discharge of a debt that is contingent may not result in income. If an obligation is so contingent that it does not constitute a debt of the taxpayer then a discharge of that debt does not give rise to income. [FN122] Mere bookkeeping entries, though of some evidentiary value, are not determinative. They cannot alter the legal effects of transactions, nor create income where none in fact exists. [FN123] ***252** If the debt is too contingent at the creation of the debt so as to allow it to be included in an asset's basis for Federal income tax purposes, then the taxpayer cannot realize income upon the release of the obligation to repay. Repayment that is highly contingent, such as upon the discovery of recoverable amounts of oil and gas [FN124] will not allow a nonrecourse note amount to be included in basis, and the forgiveness of such indebtedness will not give rise to income.

Income from discharge of indebtedness requires that the debt be cancelled. The absolute cancellation of a debt, while easy of concept, occurs infrequently. Cancellation of debt also occurs where a creditor accepts property that has a value less than the debt or an amount of money less than the debt in complete satisfaction of that debt. This may occur when the creditor is convinced that the debtor can pay no more than what is being offered or when the debt instrument carries an interest rate significantly below the now prevailing rates. [FN125] However, a cancellation of debt can also occur if the creditor fails to act timely, and his claim is barred by an applicable statute of limitations or other rule of law. [FN126] If there exists a reasonable expectation of repayment of the debt, a cancellation of the debt will not generally be found. If the expectation of repayment vanishes in a subsequent year, then a taxpayer may realize income. [FN127]

The cancellation of a debt may not be, in and of itself, the source of income but may simply be the method by which a creditor makes a payment to the debtor. [FN128] Whether such payment is ordinary income to the debtor

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depends upon the nature of payment. For example, a discharge of indebtedness may constitute a payment for services [FN129] or a constructive dividend. [FN130] A discharge of indebtedness can also constitute a contribution to capital [FN131] or a gift, [FN132] in which case the forgiveness of indebtedness is not income to the debtor. The discharge of a debt may also represent a payment for property, [FN133] in which case the gain, if any is derived from dealings ***253** in property, not the discharge of indebtedness. [FN134] The discharge of indebtedness may also constitute a payment for the settlement of a litigated claim. [FN135] Where a payment is made in settlement of litigation, the nature of the claims involved and the basis of the recovery determine the tax treatment of the settlement proceeds. [FN136] The Senate Finance Report accompanying the passage of section 108 of the Code states that "debt discharge that is only a medium for some other form of payment, such as gift or salary, is treated as the form of payment rather than under the debt discharge rules."' [FN137]

Discharge of debt is not realized where there is a modification of the debt or if the taxpayer substitutes a new obligation for the original debt. [FN138] A taxpayer will, however, recognize income on an exchange of an old obligation for a new debt instrument to the extent that the face amount of the new debt is less than the old. [FN139]

A taxpayer who is primarily liable for a debt may wish to substitute a guarantee agreement for joint and several primary liability on a debt. Under tax law, no immediate tax consequences result from the execution of a guarantee agreement. [FN140] While refinancing of a debt may preclude income realization, the substitution of a guaranty that is contingent and which has no ascertainable value vis-a-vis a true debt is not a substitute for the debt nor is it refinancing of the debt. [FN141] There is no real continuation of the indebtedness when a highly contingent obligation is substituted for a true debt. [FN142] Therefore, upon such a substitution, income is realized to the extend the taxpayer is discharged from the initial indebtedness.

XI. AMOUNT REALIZED AND ACCRUED INTEREST

As we have seen, a sale or exchange of an asset securing a nonrecourse debt that has a fair market value less than the debt will result in the amount realized being the amount of the debt. But when a taxpayer sells or disposes of property encumbered by an obligation ***254** involving accrued interest as well as principal, then, assuming the accrued interest was neither previously deducted nor included in basis, the amount realized under section 1001(B) does not include the accrued interest. Only the outstanding principal is included. [FN143] However, if the accrued interest became a part of the principal pursuant to the terms of the mortgage then it is included in the amount realized even though the taxpayer may have previously deducted these amounts. [FN144]

In Allan v. Commissioner, [FN145] the taxpayers were partners in a limited partnership which purchased residential property subject to a mortgage insured by the Department of Housing and Urban Development (HUD). The partnership deducted interest on the accrual basis of accounting. The partnership defaulted and HUD acquired the mortgage. HUD paid the real estate taxes and charged the partnership for interest payments when they fell due on the mortgage. Four years after HUD acquired the mortgage, the partnership transferred the property to HUD in lieu of foreclosure. The amount of the outstanding nonrecourse debt to HUD exceeded the fair market value of the property at the time the deed in lieu of foreclosure was given. The issue presented was whether the partnership was required to recognize ordinary income in an amount equal to the previously deducted interest and taxes. [FN146] The mortgage provided that the advances that HUD made to pay the real estate taxes and interest payments due were to be added to the principal and were subject to the mortgage interest rate. [FN147] As such the Court determined it was required by Tufts to include in the amount realized the full principal amount of the nonrecourse debt which by its own terms included the advances for real estate taxes and interest. [FN148]

XII. SECTION 108

If a taxpayer realizes ordinary income upon the voluntary or involuntary sale of an asset at a price less than the recourse debt owing against it, the nonrecognition provisions of section 108 and the ordering provisions of section

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1017 become important. Section 108 provides that if a taxpayer would otherwise recognize discharge of indebtedness income, the income will be excluded under certain circumstances. ***255** [FN149] A taxpayer must first realize discharge of indebtedness income in order to qualify for the exclusions allowed in section 108. [FN150] Section 108 applies to indebtedness incurred or assumed either by a corporation or by an individual in connection with property used in a trade or business for which the corporation or individual taxpayer is liable or subject to which the taxpayer holds the property. [FN151]

Income from discharge of indebtedness income will be excluded if the discharge occurs in a Title 11 case or if the discharge occurs when the taxpayer is insolvent. [FN152] A Title 11 exclusion takes precedence over the insolvency exclusion. [FN153]

The Code defines insolvency to mean the excess of liabilities over the fair market value of assets immediately before the discharge of indebtedness occurs. [FN154] Bankruptcy or a Title 11 case means solely that a bankruptcy court has jurisdiction over the taxpayer and that the discharge of indebtedness is granted by the court or pursuant to a plan approved by the court. [FN155]

The debt from which a taxpayer may be discharged includes that for which he is liable (recourse) and that which encumbers his property and for which he is not personally liable. [FN156] Since the Supreme Court has made no distinction between recourse and nonrecourse debt in determining the amount realized, and has considered nonrecourse debt to be real debt for tax purposes, the inclusion of nonrecourse debt in the definition of indebtedness of a taxpayer is mandated.

The Tax Reform Act of 1986 repealed a third category for discharges of indebtedness after December 31, 1986. [FN157] The now-defunct third category provided that cancellation or discharge of indebtedness income would not be recognized if the indebtedness discharge was "qualified business indebtedness."' [FN158] This exception was repealed because Congress believed that the prior law treatment of the discharge of qualified business indebtedness was too ***256** generous in that income from such a discharge generally was deferred by reducing the basis of depreciable assets, regardless of the economic ability of the taxpayer to currently pay the tax. Moreover, the exclusion produced disparate results among taxpayers depending upon the makeup of their depreciable assets. [FN159]

The question of whether a debt is discharged in a Title 11 proceeding or not depends solely upon whether the taxpayer has filed for protection under Title 11 and whether the debt has been all or partially discharged pursuant to a court order or pursuant to an approved plan of arrangement under court supervision. [FN160] The Internal Revenue Code provides that a taxpayer who meets these criteria does not have income from the cancellation or discharge of indebtedness. [FN161]

The insolvency exception applies to the extent the taxpayer is insolvent before the debt is discharged and solvent afterwards with income realized to the extent the taxpayer is made solvent. [FN162] Insolvency is defined to mean the excess of a taxpayer's liabilities over the fair market value of the taxpayer's assets. [FN163] The determination of insolvency is made on the basis of the taxpayer's assets and liabilities immediately before the discharge. [FN164]

The insolvency provisions of section 108 are tested at the partnership, not the partner, level, [FN165] and the insolvency exception applies only for discharge of indebtedness income, not for other types of ***257** income, such as the cancellation of a wage claim or of rents that are due. [FN166]

The insolvency exception, while a needed provision, only applies to the extent the taxpayer is insolvent before the debt is discharged. Income is realized to the extent the taxpayer is made solvent. [FN167] Further, as stated above, in determining the extent of liabilities, there apparently is no authority for counting contingent or contested liabilities within the scope of the term liability as used to define insolvency in section 108. [FN168]

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As with most matters, a taxpayer is rarely given a free lunch. The price of a section 108 exclusion is that the taxpayer's tax attributes will be reduced to the extent the amount of income from discharge of indebtedness is excluded from gross income under section 108(a)(1). [FN169] Thus the exemption is not totally free, but lunch is paid for in a different manner. The taxpayer is given a deferral (except as noted below) on the discharge income by offsetting such amounts against the taxpayer's tax attributes. The taxpayer's tax attributes must be reduced in the following order:

(A) The net operating loss for the taxable year of discharge (if any), and any net operating loss carryover to that year;

(B) Any carryover of the general investment tax credit under Section 38;

(C) Any net capital loss generated in the taxable year of discharge and any capital loss carryover to that year;

	Recourse Debt Paid First	Nonrecourse Debt Paid First
Recourse Note	50,000	50,000
Nonrecourse Note	50,000	50,000
Fair Market Value	75,000	75,000
Sales Price (deemed amount realized)	75,000	100,000
Adjusted Basis	75,000	75,000
Gain/(Loss)	0	25,000
Debt Forgiveness	25,000	

***258 (D)** The basis of the taxpayer's assets (depreciable and nondepreciable); and

(E) Foreign tax credit carryovers. [FN170]

Before application of section 108 attribute reductions, the taxpayer must first determine his tax for the taxable year of the discharge, applying the general rules of the Code. [FN171] The reduction in net operating loss carryovers and capital loss carryovers applies to the loss (if any) for the taxable year of the discharge and then applies to reduce the loss carryovers in the order in which they arose. [FN172] Tax credits are now reduced at the rate of 33 1/3 cents for each dollar of indebtedness discharged. [FN173]

After reduction in operating losses, capital losses, and tax credits, the remainder of the amount of indebtedness that was discharged is applied to the taxpayer's assets (depreciable and nondepreciable). An important note is that the basis of a taxpayer's assets may not be reduced below the amount of the taxpayer's remaining undischarged liabilities. [FN174] Therefore, if the taxpayer sells all of his assets after debt discharge occurs but prior to the end of the tax year in which the debt discharge occurred, for an amount equal to the outstanding and nondischarged liabilities of the taxpayer, no income is recognized by the bankrupt or insolvent taxpayer.

A very important provision found in the Committee Report is the fresh start or free lunch provision. [FN175] That provision states that any amount of debt discharge that is left after the attribute reduction under section 108 is disregarded. Such excess amount of debt discharge is not income nor does it have other tax consequences. By allowing this excess to disappear, the taxpayer has obtained a fresh start and a free lunch.

In a case under Title 11 involving an individual debtor, the attribute reduction required under section 108(b) of

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 200

the Code applies to the attributes of the bankruptcy estate which succeeded to the tax attributes of the individual debtor. [FN176] The attribute reduction does not apply to the tax attributes of individual taxpayers which were generated after the filing of the bankruptcy petition. [FN177] Property of ***259** an individual debtor that is exempt such as a homestead, automobile and furnishings will not be subject to basis reduction rules. [FN178] The Code also provides that a reduction in the basis of assets pursuant to section 108 is not considered a disposition for tax purposes and there is no recapture of investment tax credit. [FN179] The Code specifically states that a taxpayer under Title 11 will not have a basis reduction in exempt property. It is silent as to insolvent taxpayers who do not require bankruptcy court protection. If silence is construed to mean a nonbankrupt taxpayer will be required to reduce his basis in all other property, including exempt property, then a large disparity exists. An insolvent taxpayer may well want to and be able to avoid filing a bankruptcy petition, but may be well advised to do so in order to retain the tax basis on his homestead, automobile and exempt furnishings. For example, if taxpayer A is insolvent in the amount of $500,000 due to a bad real estate investment and has as his sole asset a residence with a basis of $375,000, he would reduce his basis in the residence to zero. A subsequent sale for $500,000 would produce $500,000 of ordinary income (unless a section 121 exclusion is allowed). Taxpayer B, with the same amount of insolvency and the same asset and basis, files for bankruptcy protection. The debt is discharged pursuant to a court- approved plan. A subsequent sale of the residence results in a gain of $125,000 ($500,000 sales price less adjusted basis of $375,000) which may be excluded under section 121 resulting in no gain and no tax. Taxpayer A may have tax to pay of $144,000 ($500,000 x 28%).

Prior case law looked to state law to determine whether a taxpayer's assets were exempt from the claims of creditors. To the extent assets were exempt from creditor claims they were not considered in a determination of whether a taxpayer was solvent. [FN180]

Section 108(d)(10) provides a cross reference to section 1017(c)(1) for a provision which states that no reduction is to be made in the basis of exempt property of an individual debtor. The referenced section, while entitled "'Reduction Not To Be Made In Exempt Property,"' provides that no basis reduction will occur in property which the debtor treats as exempt under the Bankruptcy ***260** Code. The section does not state that no basis reduction will occur in property which a taxpayer owns that is exempt from the claims of creditors under applicable state law. The term "debtor"' has a specific definition in bankruptcy law: "[a] person or municipality concerning which a case under this title has been commenced."' [FN181] This construction would overrule prior case law and treat insolvent taxpayers and Title 11 debtors in a very different manner. It should not be the policy of tax law to encourage the filing of bankruptcy petitions in order to obtain more favorable tax treatment, and it would seem the better interpretation is to allow both bankrupt and insolvent taxpayers to retain basis in exempt property and have an equal fresh start.

An alternative to the ordering of the reduction of tax attributes is available to a bankrupt or insolvent taxpayer. In lieu of the normal ordering set forth above, a taxpayer may elect (but only up to the amount of insolvency) to first reduce the basis of depreciable property by all or any portion of the income from discharge of indebtedness excluded under section 108(a)(1). [FN182] The general rule that prohibits a taxpayer from reducing the basis of his depreciable assets below the amount of the taxpayer's remaining undischarged liabilities is not applicable. [FN183] If the taxpayer elects, the Code permits the taxpayer to elect to reduce the entire basis of the taxpayer's depreciable assets, but not below zero. [FN184]

A taxpayer makes an election to reduce basis in depreciable property on his return for the year in which the discharge of indebtedness occurs. [FN185] Once the election is made, the election can be terminated only with the Commissioner's consent. [FN186] Temporary Treasury Regulations provide that the election must be made on a statement attached to a completed Form 982, or on that form itself if the form provides a space for the election. [FN187] Failure to file the basis adjustment form can result in the full amount of the income from debt forgiveness being recognized fully in the year in which the statute of limitations for instituting suit to collect on the taxpayer's notes expires. [FN188]

***261** XIII. SECTION 1017

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The operational rules for reducing the basis in assets are contained in section 1017 of the Code, which controls for reducing basis under section 108(b)(2)(D) or under the election in section 108(b)(5). Section 1017(b)(1) states that the order of reduction of the basis of the particular assets will be determined pursuant to Treasury Regulations. The Regulations [FN189] require that basis reduction will first apply only to property used in a trade or business in the following order:

(A) In the case of indebtedness used to purchase a particular asset (other than inventory, notes or accounts receivable) that is discharged, the cost or other basis of such property will be decreased by the amount excluded from gross income under IRC § 108(a) which is attributable to the discharged debt used to purchase that property. This is so even if a lien is placed against the property securing payment of that debt;

(B) In the case of property that has a nonpurchase money lien against it (other than inventory, notes or accounts receivable), the cost or other basis of such property will be decreased by an amount equal to the amount excluded from gross income under IRC § 108(a) and attributable to the discharge of indebtedness secured by such lien;

(C) Any remaining excess will next be applied proportionately to other property of the taxpayer (other than inventory, notes and accounts receivable); and

(D) Any remaining excess will next be applied proportionately to inventory, notes and accounts receivable. [FN190]

If after application of the above, nontaxable income from discharge of indebtedness remains, a taxpayer looks to the basis of property he holds for the production of income. In the case of an individual the cost or other basis in property held for the production of income is reduced on a proportionate basis. [FN191] Any excess nontaxable income from discharge of indebtedness after application of the above is then applied against basis in property other than property used in any trade or business and property held for the production of income, with such reductions also being made on a proportionate basis. [FN192]

***262** As can be seen, all the property of a taxpayer can realize a basis reduction. But here the bankrupt taxpayer appears to have the advantage. As stated above, property which is treated by the debtor as exempt in a bankruptcy case will not be subject to the basis reduction rules. [FN193] If the Code gives disparate treatment to debtor and nondebtor insolvent taxpayers in this area, then a bankruptcy filing may serve to save a considerable amount of basis and attendant tax upon disposition of those exempt assets.

XIV. RECAPTURE OF DEPRECIATION

To the extent the taxpayer has had a free lunch of debt forgiveness, the case is closed. To the extent the taxpayer paid for lunch with a postponement via a basis reduction in his property, the taxman waiteth. A taxpayer will report debt forgiveness basis adjustments as ordinary income upon disposition of the asset. The Committee Report states: "This rule operates to ensure that the taxpayer has only obtained a postponement of the recognition of the income and not a complete exemption from recognition."' [FN194] If the basis of property is reduced under the general attribute rule of section 108(b)(2)(D) or the special election under section 108(b)(5), any gain realized on a subsequent sale or disposition of non-sections 1245 and 1250 property will be treated as the recapture of depreciation under section 1245 to the extent of basis reduction under section 108. [FN195] A special rule for section 1250 property applies. [FN196] The recapture rules imposed by section 1017(d) apply to all assets whether depreciable or nondepreciable. Since an insolvent taxpayer who does not file for bankruptcy protection may be treated differently than one who has filed under Title 11, do these rules control over section 1034 dealing with the nontaxable exchange of a residence, and how does a taxpayer treat the over age 55 exemption on sale of a residence? [FN197] The smarter policy, one would hope, would be one of equal tax treatment and preservation of the special treatment afforded a taxpayer on the sale or exchange of a residence.

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 202

*263 XV. PURCHASE PRICE ADJUSTMENTS

Not all reductions in indebtedness will activate discharge of indebtedness rules. If a taxpayer purchases property which is financed by the seller of the property and the seller subsequently reduces the amount of the purchase money debt, the reduction will be treated as a purchase price adjustment and not income to the payor if the reduction does not occur in a bankruptcy case or when the purchaser is insolvent. [FN198] Further, the amount of the reduction must otherwise qualify as discharge of indebtedness income. [FN199] Since discharge of indebtedness income cannot arise with use of nonrecourse debt this provision is inapplicable to nonrecourse debt. Section 108(e)(5) will apply only if the seller and buyer have retained the same position vis-a-vis each other (buyer has not conveyed property nor seller assigned note) and section 108(e)(5) will not apply where the debt is reduced other than by a direct agreement between the seller and buyer such as the running of the statute of limitations on a portion of the debt. [FN200] While the other basis reduction rules do not treat the reduction as a disposition, a purchase price adjustment will trigger the recapture of business credits. [FN201]

XVI. SUMMARY

The voluntary or involuntary conveyance of an asset is a sale or exchange of that asset under section 1001. If the asset secured nonrecourse debt the amount realized upon that sale will never be less than the amount of that debt. The amount of the gain will be the difference between the adjusted basis of the property and the debt secured by it. There can be no debt forgiveness.

If, however, the property secures payment of a recourse debt, the fair market value of the property, if less than the debt, enters the equation. The gain is the difference between the adjusted basis in the property and its fair market value. The remaining amount of the debt will be categorized as debt forgiveness and ordinary income.

A taxpayer may litigate the amount of debt forgiveness by putting in issue the amount for which the property was sold or bid on at foreclosure sale in state court.

Since the definition of liabilities for purposes of determining insolvency under section 108 precludes the addition of contingent ***264** claims, can a taxpayer include the amount he is being sued for on a deficiency judgment if he contests the entirety of the claim?

The insolvency exception should not be available to exclude gain realized on the disposition of an asset secured by a nonrecourse note if that asset has a fair market value less the debt since a taxpayer will have no change in his net worth after disposition. The exception is limited to cancellation of indebtedness income. The exceptions under section 108 offer a taxpayer some ability to defer the tax on the recognized ordinary income and can even result in the true forgiveness of the debt and attendant tax consequences. The perceived disparity in treatment on exempt assets between a debtor taxpayer and an insolvent taxpayer who does not file for bankruptcy protection can cause very divergent final results.

CONCLUSION

What was confusing and allowed for various theories of tax treatment, namely the manner of treatment of nonrecourse liabilities upon a sale or exchange of an asset, was settled with Tufts. We could then treat nonrecourse and recourse alike for this purpose. What appeared settled before the issuance of Treasury Regulation § 1.1001-2(a)(2), namely treatment of recourse debt on the sale or exchange of an asset with a fair market value less than the debt, is now confusing and may allow for different theories of tax treatment. The inability to get basis in seller-financed nonrecourse indebtedness of real estate due to the change to section 465 means that a greater amount of real estate sales will have attendant recourse loans. A decline in value will leave the solvent taxpayer with the prospect of a large amount of ordinary income if payment on the deficiency has not been made.

The insolvency exception under section 108 and the basis reduction ordering rules under section 1017, while

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appropriate, seem to offer divergent treatment on the basis reduction of exempt property. This is particularly important in Texas where a residence may be claimed as exempt irrespective of the taxpayer's basis in it. Bankruptcy, in this instance, may give rise to the phoenix rising from the ruins.

The growth of tax shelters and the cost to the taxpayers in policing and legislation related to tax shelters may have been spared had the Supreme Court declined to give nonrecourse debt the status of recourse debt. We would truly have a bifurcated approach but one that has more basis in the realities of the difference in personal liability and nonpersonal liability debt. That Justice O'Connor would ***265** like to treat both types of debt again in the identical manner only seems to further distance tax treatment in this area from what the taxpayer perceives to be reality. The present bifurcated approach that can result in ordinary income from debt forgiveness and capital loss by use of recourse financing, but never ordinary income from debt forgiveness (and rarely loss) by use of nonrecourse financing, does not seem justified. The introduction of passive gain and loss and, in particular, section 469(e)(1)(A)(ii) of the 1986 Act will further produce disparate tax treatment regarding the disposition of property securing recourse and nonrecourse debt.

That a judge should accuse tax practitioners of financial fantasies constructed of gossamer wings and of sophisticated tax legerdemain can only mean that he, too, has tried to read the Code and tax cases and failed to comprehend the distinctions without difference that become difference with distinction.

FNa J.D. Baylor 1973; Sullins, Johnston, Rohrbach & Magers, Houston, Texas. Board Certified Commercial Real Estate Law. Thesis prepared in satisfaction of requirements for LL.M. Degree in Taxation, University of Houston Law Center.

FN1 In re Maxim Indus., Inc., 22 Bankr. 611, 613 (Bankr. D. Mass. 1982). "'Bankruptcy is perceived as a haven for wistfulness and the optimist's valhalla where the atmosphere is conducive to fantasy and miraculous dreams of the phoenix rising from the ruins. Unfortunately, this court is not held during the full moon, and while the rays of sunshine sometimes bring the warming rays of the sun, they more often also bring the bright light that makes transparent and evaporates the elaborate financial fantasies constructed of nothing more than gossamer wings and of sophisticated tax legerdemain."' Id.

FN2 Revenue Act of 1938, ch. 289, § 111(b), 52 Stat. 484 (1938).

FN3 Brons Hotels, Inc. v. Commissioner, 34 B.T.A. 376 (1936); Haass v. Commissioner, 37 B.T.A. 948 (1938).

FN4 Revenue Act of 1938, ch. 289, § 113(b), 52 Stat. 493 (1938).

FN5 Crane v. Commissioner, 3 T.C. 585, 589 (1944).

FN6 Id.

FN7 See Commonwealth, Inc. v. Commissioner, 36 B.T.A. 850 (1937); Lapsley v. Commissioner, 44 B.T.A. 1105 (1941); Polin v. Commissioner, 114 F.2d 174 (3d Cir. 1940).

FN8 Crane, 3 T.C. at 590.

FN9 I.R.C. § 465 (1988).

FN10 Crane v. Commissioner, 331 U.S. 1 (1947).

FN11 Id. at 3. The property was appraised at $262,042.50, the amount of the unpaid principal and the interest accrued at the time of the appraisal. Id. at 4.

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FN12 Id.

FN13 Id. at 4-5. $262,042.50 less land basis of $55,000 less depreciation allowable of $28,045.10 equals an adjusted basis of $178,997.40. The Service calculated the amount realized as the net amount of cash ($2,500) plus unpaid principal of the note ($255,000) and allocated this amount between land and building.

FN14 Id. at 9-10.

FN15 Id. at 13.

FN16 Id. (citing United States v. Hendler, 303 U.S. 564 (1938)).

FN17 Crane, 331 U.S. at 14.

FN18 Id.

FN19 Id. at 16.

FN20 Id.

FN21 Id.

FN22 Id. at 14 n.37.

FN23 See Millar v. Commissioner, 577 F.2d 212 (3d Cir.), cert. denied, 439 U.S. 1046 (1978); Estate of Delman v. Commissioner, 73 T.C. 15 (1979).

FN24 See, e.g., Mendham Corp. v. Commissioner, 9 T.C. 320 (1947); Lutz & Schramm Co. v. Commissioner, 1 T.C. 682 (1943), nonacq., 1943 C.B. 35.

FN25 461 U.S. 300 (1983).

FN26 Id. at 302-03.

FN27 Id. n.1. The loss was the difference between the adjusted basis, $1,445,740, and the fair market value of the property, $1,400,000.

FN28 Id. n.2. The Commissioner determined partnership gain on the sale by subtracting the adjusted basis, $1,455,740, from the liability assumed, $1,851.500.

FN29 Id. at 307.

FN30 Rev. Rul. 76-111, 1976-1 C.B. 215.

FN31 Tufts, 461 U.S. at 308.

FN32 Id. at 311 n.11.

FN33 26 C.F.R. § 1.1001-2 (1982), 1981-2 C.B. 430 (1980).

FN34 Tufts, 461 U.S. at 306 n.11. "'We are not presented with and do not decide the contours of the cancellation-of-indebtedness doctrine."DD'

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FN35 Id.

FN36 Eustice, Cancellation of Indebtedness and the Federal Income Tax: A Problem of Creeping Confusion, 14 TAX L. REV. 225 (1959).

FN37 See Helvering v. Hammel, 311 U.S. 504 (1941).

FN38 Id. at 507.

FN39 Id. at 508 (citing Revenue Act of 1934, ch. 277, § 117(d), 48 Stat. 683 (1934). See I.R.C. §§ 1001, 1231 (1986).

FN40 Id. at 508.

FN41 I.R.C. § 465(b)(6)(A) (1988). "'Notwithstanding any other provision of this subsection, in the case of an activity of holding real property, a taxpayer shall be considered at risk with respect to the taxpayer's share of any qualified nonrecourse financing which is secured by real property used in such activity."' Id.

FN42 TEX. PROP. CODE ANN. § 51.002 (Vernon 1988).

FN43 Maxey v. Texas Commerce Bank, 571 S.W.2d 39, 45 (Tex. Civ. App. --Amarillo 1978, writ ref'd n.r.e.)

FN44 "The phrase 'grossly inadequate' has been judicially defined as 'consideration so far short of the real value of the property as to shock a correct mind, and thereby raises a presumption that fraud attended the purchase."DD" Id. at 45, (citing Richardson v. Kent, 47 S.W.2d 420, 425 (Tex. Civ. App. -- Dallas 1982, no writ)).

FN45 Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980).

FN46 Id. at 203.

FN47 Id. at 203.

FN48 Willis v. Borg-Warner Acceptance Corp., 48 Bankr. 295 (Bankr. D. D.C. 1985).

FN49 Id. at 301.

FN50 See supra note 43 and accompanying text.

FN51 Lee v. Sabine Bank, 708 S.W.2d 582 (Tex. App. -- Beaumont 1986, writ ref'd n.r.e.).

FN52 Id. at 584.

FN53 Id.

FN54 "We, therefore, hold that when a lender or its surrogate purchases collateral to secure a loan given by a borrower, and where there is a probable significant disparity between the sales price of the property and its fair market value, the borrower may contest the sale and present evidence contending such."' Id. at 585.

FN55 Weiner v. American Petrofina Mktg., Inc., 482 So. 2d 1362 (Fla. 1986), additional credit up to fair market value allowed; Brown v. C.I.T. Corp., 258 S.E.2d 44 (Ga. Ct. App. 1979), no deficiency judgment of sale not commercially reasonable; Morgan v. Freel, 513 P.2d 461 (Colo. Ct. App. 1973), lender to account to borrower for sums up to fair market value of property.

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FN56 Freeland v. Commissioner, 74 T.C. 970 (1980).

FN57 Id. at 971.

FN58 Id. at 971-72 (citing § 508b, California Code of Civil Procedure).

FN59 Id. at 973.

FN60 Id. at 973. "'The amount of the loss was arrived at by including in petitioner's basis the cash he paid plus the face amount of the purchase-money mortgage (and the escrow fee) and subtracting therefrom the unpaid balance due on the mortgage, thus including in the 'amount realized' the full unpaid balance due on the nonrecourse obligation."' Id. at 973 n.2.

FN61 Id. at 973. Section 1211 provides for a limitation on capital basis and § 1212 allows for capital loss carrybacks and carryovers.

FN62 Id. at 974.

FN63 Id.

FN64 Id.

FN65 Id. (citing Gerhard v. Stephens, 442 P.2d 692, 69 Cal. Rptr. 612 (1968)).

FN66 Id. at 974. See, e.g., Parker v. Delaney, 186 F.2d 455 (1st Cir. 1950).

FN67 Schleppy v. Commissioner, 601 F.2d 196 (5th Cir. 1979); Smith v Commissioner, 66 T.C. 622 (1976); Fox v. Commissioner, 61 T.C. 704 (1974).

FN68 Freeland v. Commissioner, 74 T.C. 970, 975 (1980).

FN69 Id. at 975-76 (citing Stamler v. Commissioner, 145 F.2d 37 (3rd Cir. 1944)); Kaufman v. Commissioner, 119 F.2d 901 (9th Cir. 1941); Peninsula Properties Co. v. Commissioner, 47 B.T.A. 84 (1942).

FN70 See supra note 24 and accompanying text.

FN71 Crane v. Commissioner, 331 U.S. 1 (1947).

FN72 Freeland, 74 T.C. at 981.

FN73 Yarbro v. Commissioner, 84-2 USTC 84,969 (1984).

FN74 Id. at 84,970.

FN75 Id.

FN76 Id.

FN77 The taxpayer's total cash investment in the joint venture of $10,250. Id. at 84,970-84,971.

FN78 Id. at 84,971.

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FN79 Id.

FN80 Middleton v. Commissioner, 77 T.C. 310 (1981), aff'd, 693 F.2d 124 (11th Cir. 1982).

FN81 Yarbro, 84-2 USTC at 84,974.

FN82 I.R.C. § 1001(a) (1988).

FN83 Qualifying gains and losses arise from disposition of property that constitutes a capital asset within the meaning of § 1221 (assuming satisfaction of the sale or exchange requirement of § 1222) and gains and losses from property covered by § 1231 (assuming satisfaction of the netting requirements), subject to the recapture rules of §§ 1245 and 1250.

FN84 I.R.C. §§ 62(a)(3), 1211, 1212 (1988).

FN85 See Burnet v. Sanford & Brooks Co., 282 U.S. 359 (1931).

FN86 TEX. CIV. PRAC. & REM. CODE ANN. § 16.004 (Vernon 1988).

FN87 Woltman v. United States, 85-2 USTC 89,472 (S.D. Cal. 1985) (in absence of a basis reduction election debt forgiveness income recognized in the year the statute of limitations for instituting suit for collection of debt expires). But see Callan Court Co. v. Commissioner, T.C.M. (CCH) 1965-261, 24 TCM 1419 (1965) (discharge income in year debt written off a loss rather than in year statute of limitations had run on enforcement of debt); Priv. Ltr. Rul. 86-49-051 (Sept. 10, 1986) (actual foreclosure sale determines date of recognition under I.R.C. § 1001).

FN88 I.R.C. §§ 108(b)(5), (d)(9) (1988); see I.R.C. § 1017 (1988), regarding manner of reduction.

FN89 B.M. Marcus Estate v. Commissioner, 34 T.C.M. (CCH) 40, 41 (1975).

FN90 Treas. Reg. § 1.1001-2(b) (1980); see also T.D. 7741, 1981-1 C.B. 430.

FN91 Treas. Reg. § 1.1001-2(a)(2) (1980).

FN92 See generally Cunningham, Payment of Debt With Property - The Two-Step Analysis After Commissioner v. Tufts, 38 TAX LAWYER 575 (1984) (analysis and justification of this approach).

FN93 Unique Art Mfg. Co. v. Commissioner, 8 T.C. 1341 (1947), acq., 1947-2 C.B. 4; Peninsula Properties Co. v. Commissioner, 47 B.T.A. 84 (1942), acq., 1942-2 C.B. 14.

FN94 R. O'Dell Co. v. Commissioner, 8 T.C. 1165 (1947), aff'd, 169 F.2d 247 (3d Cir. 1948); Nutter v. Commissioner, 7 T.C. 480 (1946), acq., 1946-2 C.B. 4; Helvering v. Hammel, 311 U.S. 504 (1941); Parker v. Delaney, 186 F.2d 455 (1st Cir. 1950), cert. denied, 341 U.S. 926 (1951).

FN95 See supra note 81 and accompanying text.

FN96 R. O'Dell Co., 8 T.C. at 1167.

FN97 Peninsula Properties Co., 47 B.T.A. at 84.

FN98 Tufts v. Commissioner, 461 U.S. 300, 306 (1983) (citing Treas. Reg. § 1.1001-2(b)).

FN99 Id. at 309 n.7.

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FN100 Id. at 311 n.8.

FN101 Professor Wayne G. Barnett, in his Amicus Curiae brief, would have treated the facts in Tufts as if there was a transfer of the property for $1,400,000 (the fair market value), a cancellation of the $1,850,000 mortgage for payment of $1,400,000. The taxpayer then had a capital loss of $50,000 (adjusted basis, $1,450,000, less fair market value, $1,400,000, equals $50,000) and the taxpayer had ordinary income of $450,000 ($1,850,000 debt cancellation less adjusted basis of $1,400,000). This was rejected by the Court but is precisely the Service's position for treatment of Tufts' facts with recourse debt.

FN102 Tufts, 461 U.S. at 317 (O'Connor, J., concurring). Justice O'Connor apparently would adopt Professor Barnett's position set out supra note 99.

FN103 Treas. Reg. § 1.1001-2(c) example (7) (1980).

FN104 Id. example (8).

FN105 Priv. Ltr. Rul. 87-35-065 (June 4, 1987). Because you are personally liable for the balance of the outstanding debt, and the lending institution has full recourse to your assets in addition to the property proposed to be transferred, we conclude you will realize income from the discharge of indebtedness to the extent the amount of the debt cancelled exceeds the fair market value of the property transferred. See also Priv. Ltr. Rul. 85-04-010, where the taxpayer argued that the entire amount realized over its adjusted basis was discharge of indebtedness and ordinary income.

FN106

	Recourse Debt	Nonrecourse Debt
Note	100,000	100,000
Fair Market Value	75,000	75,000
Sales Price (deemed amount realized)	75,000	100,000
Adjusted Basis	100,000	100,000
Gain/(Loss)	(25,000)	0
Debt Forgiveness	25,000	

	Recourse Debt	Nonrecourse Debt
Note	100,000	100,000
Fair Market Value	75,000	75,000
Sales Price (deemed amount realized)	75,000	100,000
Adjusted Basis	75,000	75,000
Gain/(Loss)	0	25,000
Debt Forgiveness	25,000	

Tax impact on various types of property:

If a principal residence, the gain is long-term capital gain subject to the maximum tax, of 28% or possibly excludible if reinvested or over 55 years old. Any loss in non-deductible.

If a capital asset (such as land), the gain is long-term capital gain. The loss is a long-term capital loss subject to capital loss limitations (i.e. $3,000 per year).

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If the asset is business or rental property (I.R.C. § 1231), the gain is long-term capital gain; however, the loss is an ordinary deduction. Furthermore, if the gain is from a passive activity, it can be offset against losses (current year as well as suspended) from other passive activities.

See also Treas. Reg. § 1.1001-2(c) examples 4-6 (1980).

FN107 Michaels v. Commissioner, 87 T.C. 1412 (1986).

FN108 I.R.C. § 1034 (1988).

FN109 Michaels, 87 T.C. 1412.

FN110 I.R.C. § 108(e)(5) (1988).

FN111 I.R.C. § 61(a)(12) (1988). "'Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items: . . . Income from discharge of indebtedness."' Id.

FN112 Treas. Reg. § 1.61-12(a) (1980).

FN113 United States v. Rochelle, 384 F.2d 748, 751 (5th Cir. 1966).

FN114 United States v. Kirby Lumber Co., 284 U.S. 1 (1931).

FN115 Id. at 3.

FN116 I.R.C. § 61(a)(12) (1988).

FN117 Millar v. Commissioner, 540 F.2d 184 (3d Cir. 1976).

FN118 Id. at 186.

FN119 Id. at 185.

FN120 Millar v. Commissioner, 67 T.C. 656.

FN121 Millar v. Commissioner, 577 F.2d 212 (3d Cir.), cert. denied, 439 U.S. 1046 (1978).

FN122 Terminal Investment Co. v. Commissioner, 2 T.C. 1004 (1943), acq., 1944 C.B. 27.

FN123 Id. at 1013.

FN124 CRC Corporation v. Commissioner, 693 F.2d 281 (3d Cir. 1982); Brountas v. Commissioner, 50 AFTR 2nd 82-5900 (1982).

FN125 Rev. Rul. 82-202, 1982-2 C.B. 35 (prepayment discount on mortgages with below market rates of interest).

FN126 Miller Trust v. Commissioner, 76 T.C. 191 (1981).

FN127 Alexander v. Commissioner, 61 T.C. 278, 291 (1973).

FN128 Spartan Petroleum Co. v. United States, 437 F. Supp. 733 (D. S.C. 1977).

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FN129 Newark v. Commissioner, 311 F.2d 913, 915 (2d Cir. 1962).

FN130 Shephard v. Commissioner, 340 F.2d 27 (6th Cir. 1965).

FN131 Perlman v. Commissioner, 252 F.2d 890 (2d Cir. 1958).

FN132 Capital Coal Corp. v. Commissioner, 26 T.C. 1183 (1956), aff'd, 250 F.2d 361 (2d Cir. 1957).

FN133 See supra note 16.

FN134 Danenberg v. Commissioner, 73 T.C. 370 (1979).

FN135 Commercial Electrical Supply Co. v. Commissioner, 8 B.T.A. 986 (1927).

FN136 Henry v. Commissioner, 62 T.C. 605 (1974).

FN137 S. Rep. No. 1035, 96th Cong., 2nd Sess. 8 n.6, reprinted in 1980 U.S. Code Cong. & Admin. News 7017, 7023; see also Treas. Reg. § 1.61-12(a) (as amended in 1968); Rev. Rul. 84-176, 1984-2 C.B. 34; Gen. Couns. Mem. 39049 (Nov. 2, 1983).

FN138 Fifteen Hundred Walnut Street Corp. v. Commissioner, 237 F.2d 933 (3d Cir. 1956).

FN139 Great Western Power Co. of California v. Commissioner, 297 U.S. 543 (1936); Rev. Rul. 77-437, 1977-2 C.B. 28.

FN140 Zappo v. Commissioner, 81 T.C. 77, 87 (1983).

FN141 Id. at 89.

FN142 Id.

FN143 Focht v. Commissioner, 68 T.C. 223 (1977), acq., 1980-2 C.B. 1.

FN144 Allan v. Commissioner, 86 T.C. 655 (1986), aff'd, 856 F.2d 1169 (8th Cir. 1988).

FN145 Id.

FN146 Id.

FN147 Id.

FN148 Id.

FN149 I.R.C. § 108(a) (1988).

FN150 Colonial Savings Association v. Commissioner, 85 T.C. 855 (1985), aff'd, 854 F.2d 1001 (7th Cir. 1988) (penalties received by association for premature withdrawals of deposits were not discharge of indebtedness income).

FN151 Treas. Reg. § 1.108(a)-1(a)(1) (1960).

FN152 I.R.C. § 108(a) (1988).

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FN153 Id. § 108(a)(2).

FN154 Id. § 108(d)(3).

FN155 Id. § 108(d)(2).

FN156 Id. § 108(d)(1).

FN157 Tax Reform Act of 1986, Pub. L. 99-514 § 822(a), 100 Stat. 2085, 2373 (1986).

FN158 I.R.C. § 108(a)(1)(c) (1954).

FN159 Witt, Troubled Real Estate: Tax Aspects, Fourth Annual Advanced Institute for Partnership and Real Estate Tax Planning, State Bar of Texas (1987).

FN160 I.R.C. § 108(d)(2) (1988), definition of a Title 11 case is a bankruptcy case under Title 11 of the United States Bankruptcy Code, but only if the taxpayer is under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court.

FN161 Id. § 108(a)(1)(A).

FN162 I.R.C. § 108(a)(3) (1988); see also Gershkowitz v. Commissioner, 88 T.C. 984, 1006 (1987); Estate of Delman v. Commissioner, 73 T.C. 15, 32 (1979).

FN163 I.R.C. § 108(d)(3) (1988).

FN164 Id.

FN165 Priv. Ltr. Rul. 83-48-001 (Aug. 18, 1983). This Private Letter Ruling also points up the difference in the event the property secures part recourse and part nonrecourse debt and is disposed of. The Service believes the recourse debt will be paid first. For example:

Which of the above results is most desirable? Of course, the answer depends in part on the following factors:

a. The type of property involved (residence or 1231 property);

b. Whether the taxpayer is insolvent or filing for bankruptcy;

c. Personal tax attributes such as capital loss carryovers; and

d. Whether the recourse debt is actually forgiven.

FN166 Gershkowitz v. Commissioner, 88 T.C. 984 (1987).

FN167 Haden Co. v. Commissioner, 118 F.2d 285 (5th Cir.), cert. denied, 314 U.S. 622 (1941); Texas Gas Distrib. Co. v. Commissioner, 3 T.C. 57 (1944), acq., 1944 C.B. 27.

FN168 Pri. Ltr. Rul. 83-48-001 (Aug. 18, 1983) (citing United States v. Consolidated Edison, 366 U.S. 380 (1961)).

FN169 I.R.C. § 108(b) (1988).

FN170 I.R.C. § 108(b)(2)(A)-(E) (1988).

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FN171 Id. § 108(b)(4).

FN172 See id. § 172(b)(2).

FN173 Id. § 108(b)(3)(B).

FN174 S. Rep. No. 1035, 96th Cong., 2nd Sess. 13, reprinted in 1980 U.S. Code Cong. & Adm. News 7017, 7028; I.R.C. § 1017(b)(2) (1986).

FN175 Id.

FN176 I.R.C. § 1398(g) (1986).

FN177 Id. § 108(d)(8).

FN178 Id. § 1017(c)(1); for property treated as exempt, see 11 U.S.C. § 522 (1982).

FN179 Rev. Rul. 81-206, 1981-2 C.B. 9.

FN180 Davis v. Commissioner, 69 T.C. 814, 833-4 (1978); B.M. Marcus Estate v. Commissioner, 34 T.C.M. (CCH) 38 (1975) (in determining that excess assets exempt from the claims of creditors under state law are not to be included among the assets of the estate); Rufus S. Cole v. Commissioner, 42 B.T.A. 1110 (1940) (in determining whether or not petitioner was solvent or insolvent after cancellation of the debt, his exempt property should not be considered).

FN181. 11 U.S.C. § 101(12) (1982).

FN182. I.R.C. § 108(b)(5) (1988); Id. § 1017(b)(3)(E).

FN183. Id. § 108(b)(5)(C).

FN184. Id. §§ 108(b)(5) and 1017(b)(2).

FN185. Id. § 108(b)(5).

FN186. Id. § 108(d)(9).

FN187. Temp. Treas. Reg. § 7a.1(d)(1).

FN188. Woltman v. United States, 85-2 USTC Par. 9581 (S.D. Cal. 1985).

FN189. Treas. Reg. § 1.1017-1(a).

FN190. Treas. Reg. § 1.1017-1(a)(1-4) (paraphrased).

FN191. Treas. Reg. § 1.1017-1(a)(5).

FN192. Treas. Reg. § 1.1017-1(a)(6).

FN193. I.R.C. § 1017(c)(1) (1988).

FN194. Committee Report, supra note 172, at 7029.

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FN195. I.R.C. § 1017(d)(1) (1988).

FN196. Id. § 1017(d)(2). For purposes of § 1250(b), the determination of what would have been the depreciation and adjustments under the straight line method shall be made as if there had been no reduction under this section.

FN197. Id. § 121. Can the gain be sheltered up to the applicable amounts or does § 1017 control and require inclusion of gain up to the amount of basis reduction?

FN198. Id. § 108(e)(5).

FN199. Id. § 108(e)(5); Juister v. Commissioner, 53 T.C.M. (CCH) 1079 (Section 108(e)(5) held not to apply to reduction of non-purchase money indebtedness).

FN200. Committee Report, supra note 172, at 7030.

FN201. Committee Report, supra note 172, at 7032.

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Arkansas Law Review

1989

*1 TAX ANATOMY OF DEBT RESTRUCTURING

James R. Monroe [FNa]

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Consideration of tax consequences is an important element of almost any major personal or business transaction. In particular, the tax implications of debt restructuring merit attention because seemingly subtle differences in the decisions made can create significantly divergent results under the current Internal Revenue Code. The following example illustrates this anomalous result and serves as a conduit for a proposal which would temper that result.

I. FACTUAL PATTERN

As of December 1, 1987, Ezra and Samantha Rich had the following assets and liabilities:

ASSETS	FAIR MARKET VALUE	ADJUSTED BASIS
Land/Building	$400,000	$100,000
Equipment	40,000	30,000
Inventory	100,000	90,000
Stocks	504,000	50,000
Personal Residence	175,000	70,000
Chevrolet	7,000	10,000
	$1,226,000	$350,000
LIABILITIES	**PRINCIPAL**	**INTEREST**
Friendly Bank	$ 500,000	$ 75,000
Easy Loan Company	1,000,000	150,000
GM Credit	8,000	500
First Credit Union	300,000	20,000
Asiv Card	10,000	4,000
	$1,818,000	$249,500

Obviously, the Riches are unable to meet their financial commitments and have a negative net worth of $841,500. [FN1] In agonizing *2 over the decision to restructure their financial obligations, they decided to talk with I. M. Slack, their attorney.

Mr. Slack informed the Riches that they may have causes of action against Easy Loan for fraud and misrepresentation and against Friendly Bank for the decrease in value of the Riches' assets, which the bank was managing. [FN2] After reviewing the financial statements of the Riches and considering their threatened legal actions through negotiations with Mr. Slack, Easy Loan is willing to satisfy the Riches' obligation if the Riches transfer their land and building to Easy Loan. Similarly, Friendly Bank agrees to accept $200,000 in cash from the Riches in full satisfaction of the Riches' debt to Friendly Bank. Finally, the Riches contacted their tax adviser regarding the implications of the proposed debt restructuring.

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The Riches' situation is a common yet frightening occurrence in many areas of the United States. [FN3] The tax implications of a proposal like the Riches' are initially ignored by *3 many taxpayers and their advisers. However, without proper tax planning the Riches and similarly situated taxpayers will have to live daily with the tax consequences as the tax collector seeks the government's due from the debt restructuring. [FN4]

In order to minimize or avoid altogether the tax effects of debt restructuring, the Riches and their advisers must first be aware of the adverse tax consequences of the restructuring. These consequences are analyzed in Section II of this Article, while Section III provides an explanation of alternatives to avoid or minimize the adverse tax consequences. An amendment to the Internal Revenue Code (Code), [FN5] which would relieve the tax burden of many debtors caused by debt restructuring, is proposed in Section IV. This proposed amendment should add certainty and equity to transactions involving debt restructuring.

II. TAX LAW--DEBT RESTRUCTURING

A. General Rule--The Problem of Debt Discharge Income

The Supreme Court in United States v. Kirby Lumber Co. [FN6] held that a taxpayer which purchased its own bonds for *4 less than the issue price had gross income to the extent that the issue price exceeded the purchase price. Therefore, as a general rule, when a taxpayer has debt reduced by a creditor without payment of full consideration, the taxpayer has cancellation of indebtedness (debt discharge) income (CODI) equal to the excess of the cancelled debt over the amount of consideration paid by the debtor for the cancellation. [FN7] Thus, applying the general rule and ignoring its exceptions, [FN8] the Riches will report debt discharge income (CODI) in the amount of $750,000 [FN9] from the reduction of the Easy Loan obligation and $375,000 [FN10] from the reduction of the Friendly Bank obligation. Obviously, the income resulting from CODI presents tax planning problems for the taxpayer and the tax adviser.

B. Relief--Exceptions to General Rule

1. Background

Long after the Kirby Lumber decision, [FN11] lower courts found exceptions to the general rule of CODI when debt was discharged for less than the full amount owed by the debtor. These courts evidently believed the general rule was too harsh in certain circumstances and formulated various exceptions:

a. Exclusion to the extent that the taxpayer was insolvent before the debt cancellation, but only to the extent *5 of the insolvency. [FN12]

b. Exclusion if cancellation of the taxpayer's debt results in no net gain to the taxpayer. [FN13]

c. Exclusion if the debt cancellation is a purchase price adjustment. [FN14]

d. Exclusion if the debt cancellation is a gift. [FN15]

If the taxpayer could come within one of these exceptions, all or part of the CODI could be excluded from gross income, thereby giving full or partial relief from the general rule of Kirby Lumber.

2. Congressional Response

To clarify the feneral rule of Kirby Lumber, to add certainty to its exceptions, and to adopt tax provisions to replace those repealed by the Bankruptcy Act of 1978, [FN16] Congress in 1980 codified a somewhat modified version of the exceptions. [FN17] Under the codification, CODI is excluded from a taxpayer's *6 gross income if the discharge occurs:

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 217

a. While the taxpayer is subject to bankruptcy proceedings and the bankruptcy court either has issued a discharge order concerning the debt or discharge is pursuant to a plan approved by the court; [FN18] or,

b. While the taxpayer is insolvent, but only to the extent of the taxpayer's insolvency; [FN19] or,

c. For interest or other expenses which, if paid, would be deductible by the taxpayer; [FN20] or,

d. When the taxpayer is not subject to bankruptcy and is not insolvent if the debt reduction occurs as a result of a purchase price adjustment with the original seller. [FN21]

In 1986, Congress adopted another CODI exclusion--one for qualified farmers who are solvent at the time of debt discharge. [FN22] Under this provision, CODI is excluded as if the ***7** qualified farmer were insolvent. However, this CODI exclusion has been both limited and expanded by the Technical and Miscellaneous Revenue Act of 1988. [FN23]

The exclusion of the CODI from gross income may affect the debtor/taxpayer's tax attributes--examples of which are net operating losses, capital losses, tax credits, and adjusted basis in assets. [FN24]

Numerous articles have already explored the statutory exceptions to debt discharge income. [FN25] Therefore, except for application of these rules to the Riches' situation, these statutory exceptions will not be analyzed further. However, other planning techniques to avoid adverse tax effects from debt restructuring will be explored. [FN26]

3. Application of Exceptions to Riches

a. Initial Result

If the Riches restructure their debts as proposed, under the general rule of Kirby Lumber and absent application of the statutory exceptions, the Riches must report $1,125,000 [FN27] of income from the debt discharge. A substantial portion of this income, however, can be excluded from the Riches' gross income by invoking the statutory exceptions. [FN28]

***8** b. Interest

Because the payments to Friendly Bank and Easy Loan are insufficient to pay the principal, the interest is regarded as cancelled. [FN29] If the Riches are cash basis taxpayers and entitled to deduct the interest if paid, the cancelled interest will be excluded from gross income and will not be classified as CODI. [FN30] The cancelled interest would be includable in gross income if the Riches were accrual basis taxpayers and had deducted the unpaid interest. [FN31]

c. Insolvency

Additionally, because the Riches are insolvent (liabilities of $1,842,500--assuming the interest owed to Friendly Bank and Easy Loan Company is excludable under Code § 108(e)(2)-- [FN31] exceed the fair market value of assets of $1,051,000), [FN33] they can exclude up to the amount of their insolvency ($791,500) from their gross income. [FN34] Thus, the CODI [FN35] in excess of the amount excluded as interest or under the insolvency rule ($108,500) will be included as gross income on the Riches' tax returns subject to the exceptions and planning techniques discussed in Section III.

***9** C. Gain

A surprise to taxpayers, in addition to the discharge of indebtedness income, sometimes results when

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appreciated assets are transferred to satisfy a debt obligation. [FN36] For example, the Riches propose to transfer their land and building to Easy Loan to satisfy their obligation of $1,150,000. [FN37] If the Easy Loan liability is nonrecourse [FN38] (nonpersonal) to the Riches, the Riches will have a gain of $1,050,000 with no CODI to report. [FN39] On the other hand, if the Riches' liability to Easy Loan is recourse [FN40] (personal), the Riches' gain, according to the Treasury Department Regulations, will be $300,000. [FN41] The remainder of the Easy Loan indebtedness ($750,000) in excess of the fair market value of the land and buildings ($400,000) will be CODI and subject to the CODI exception. [FN42]

Originally, the Treasury Department acquiesced in a case holding that no gain resulted from the transfer of appreciated property to a creditor to discharge a debt because the discharge ***10** resulted in CODI to the debtor/ taxpayer. [FN43] However, the Treasury Department recently withdrew its acquiescence and currently takes the position that a taxpayer who transfers appreciated property to satisfy a recourse debt has gain rather than CODI to the extent that the lesser of the asset's fair market value or the cancelled debt exceeds the adjusted basis of the asset. [FN44]

Recently, the IRS argued that no loss deduction should be allowed a taxpayer who did not sustain an economic loss. [FN45] Query whether a taxpayer could argue that no gain should be reported where there is no economic gain. This would be the situation if the taxpayer is insolvent both before and after the transfer of property to the creditor.

The importance of this distinction between gain and cancellation of indebtedness income under the current Code, Treasury Regulations, rulings, and case law should not be overlooked. CODI may be excluded from gross income under one of the above exceptions, whereas gain is not subject to these exclusions. [FN46] Thus, gain will be subject to the usual gain-related rules of realization, recognition, capital gains, depreciation recapture, and section 1231 treatment. [FN47]

D. Options

Without utilization of the tax planning techniques discussed in Section III, if the Riches settle their financial obligations as suggested, they may incur substantial federal income tax liability. The relevant factors considered in determining ***11** that liability may include the availability of net operating losses, capital losses, and credits to offset the CODI of $108,500; the gain of $300,000; or the tax resulting from the gain or CODI. If the Riches do incur substantial tax liability, their options may be limited to one, or a combination, of the following:

1. Pay the tax liability either at once or under an installment payment agreement. [FN48]
2. File bankruptcy in an attempt to discharge the liability. [FN49]
3. Make an offer in compromise. [FN50]
4. Ignore the liability. [FN51]

Any of these options--except the final one which is unrealistic and too simplistic in most cases--may involve substantial present and future financial hardships to the Riches.

III. TAX PLANNING TECHNIQUES TO AVOID UNDESIRED TAX EFFECTS

A. Overview of the Problem

As the previous discussion illustrates, adverse tax effects of the proposed debt restructuring may force the Riches into further financial hardship and may require bankruptcy [FN52] if ***12** they are unable to exclude the CODI or gain from their gross income. However, the Riches should first consider the following methods for

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excluding CODI from their gross income:

Plan 1. Allocation of some of the CODI to damages suffered by the Riches.

Plan 2. Transfer of property to the spouse with the lower income potential.

Plan 3. Change of the debt from nonrecourse to recourse.

Plan 4. Other less practicable alternatives.

B. Plan 1--Damages

1. General Rules

a. Personal Damages

If a taxpayer receives compensatory damages for personal injuries, these damages are excluded from gross income. [FN53] The IRS formerly took the position that punitive damages arising from a personal injury were also excludable from gross income; [FN54] however, the IRS has recently revised its position and now contends that all punitive damages are included in gross income. [FN55]

A debtor may have numerous causes of action against a creditor arising from a loan. [FN56] If possible, a debtor should structure his or her position (complaint or petition) or settlement to take advantage of the personal damage exclusion. Causes of action which result in personal injuries and are excludable from gross income include libel, [FN57] slander, [FN58] negligence and fraud. [FN59]

b. Capital Recovery

Additional damage recoveries may result in no income if the recovery is for loss or a reduction in value of capital ***13** caused by the creditor(s). [FN60] For example, if a creditor is in a fiduciary position or has control of a debtor's assets which decline in value, the debtor's damage recovery due to loss of asset values will not result in gain to the debtor except to the extent that the amount of damages exceeds the debtor's adjusted basis in the asset. [FN61]

c. Allocation

If the judge or jury fails to allocate the damage recovery between those damage items which are excludable from gross income and those items which are includable in gross income, or if the debtor and creditor fail to allocate the damages in their settlement agreement, then the Internal Revenue Service (IRS) will allocate the award or settlement amount according to the damages pled. [FN62] If no damage amount was pled, the allocation is based upon the facts in the case. [FN63]

2. Application to the Riches

a. Personal Recovery

If the Riches have damage claims against Easy Loan and/or Friendly Bank, the Riches and their attorney should consider an allocation of any settlement amount to those damage claims which are excludable from gross income. For instance, assuming the Riches settle their damage dispute with Easy Loan for $150,000 which is allocated for emotional distress to the Riches, the $150,000 is treated as paid to the Riches by Easy Loan and no income is reported. [FN64] In addition, the Riches would be treated as having paid $150,000 to reduce the amount owed to Easy Loan. [FN65] The settlement agreement should be specific in applying the $150,000 to reduce ***14**

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principal or to pay interest, whichever is in the Riches' best interest.

If the Riches and their counsel fail to allocate the settlement amount, the IRS may allocate the settlement amount on the same basis that the amounts were allocated in the Riches' complaint or petition. [FN66] If no complaint or petition was filed, then the IRS may apply the $150,000 to the taxpayer's disadvantage. [FN67] For example, the IRS may allocate all or a portion of the damages to items not excludable from gross income, including wages, punitive damages, contract recovery, and other nonpersonal injuries. [FN68]

b. Capital Recovery

An alternative to the personal damage exclusion would be available if the Riches had grounds to claim that either creditor had breached a fiduciary relationship and that this breach had caused a decline in property values. Any recovery up to the Riches' adjusted basis in their properties, which had declined in value due to the breach, would be a return of capital. Any amount received in excess of the adjusted basis would be gain realized, and perhaps recognized, to the Riches. [FN69]

3. Conclusion

Counsel for taxpayers must be aware of the tax implications of settlement agreements and lawsuits filed. Improper or ill-advised allocations can result in adverse tax effects to debtor/taxpayers who are already in financial trouble. However, properly structured settlements may result in substantial tax savings from less gain and cancellation of indebtedness ***15** income. [FN70]

C. Plan 2--Transfer to Spouse

If the Riches transfer their land and building to Easy Loan to satisfy their obligations, the Riches will have a gain to report on their tax return [FN71] and/or CODI which may be wholly or partially excluded from gross income. [FN72] Unless the Riches have net operating losses or capital losses [FN73] to offset the gains and CODI, or, alternatively, credits to offset the resulting taxes, [FN74] the Riches will owe federal income tax as a result of the transfer of assets to their creditor(s).

The assessment, if not paid, will result in collection efforts by the IRS. [FN75] Bankruptcy may not be a viable solution because the Riches will not be able to discharge these taxes until at least three years after the taxes are assessed. [FN76] Thus, the Riches' income for the three year period will be subject to levy by the IRS. Additionally, any acquisition of assets or increase in asset value during the three years will be subject to the tax lien or levy. [FN77]

As an alternative to the Riches' transfer of the land and building to Easy Loan, they should consider transferring the real estate from the spouse who is either earning more income or has more income potential (transferor spouse) to the other spouse (transferee spouse). This transfer will result in no gain ***16** or loss to the transferor spouse. [FN78] The transferee spouse will acquire the same adjusted basis in the land and building as did the transferor spouse. [FN79]

Upon transfer of the real estate to Easy Loan, the transferee spouse will have either gain or loss to report, and both the transferee and transferor may have CODI. [FN80] However, both transferee and transferor spouses can attempt to exclude the CODI from gross income under the insolvency exclusion or other applicable exclusions. [FN81]

If the transferee spouse reports gain (which results in the assessment of income tax on that gain) and the transferor spouse has no gain to report, the transferor spouse will not be taxed on the gain if the spouses file separate income tax returns. Furthermore, the transferor will not be taxed on the CODI if one of the CODI exceptions applies. [FN82] Therefore, the transferor can have a substantial salary, purchase assets which may

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appreciate in value, and own a sole proprietorship without fear that the IRS will levy on these assets and income. [FN83]

The IRS may attempt to collapse the transfer between the spouses and argue that the subsequent transfer from the transferee spouse to Easy Loan was in reality a transfer from both spouses to the creditor. This is commonly known as the step transaction doctrine. [FN84] Application of this doctrine may ***17** be avoided if sufficient time elapses between the initial transfer between the spouses and the subsequent transfer to Easy Loan. [FN85] Moreover, if the purpose of the transfer between the spouses is estate planning [FN86] or business related, [FN87] application of the doctrine may similarly be avoided.

D. Plan 3--Nonrecourse to Recourse Debt

As previously stated, when a debtor transfers property to a creditor to satisfy a debt, the tax consequences differ depending upon various factors:

1. whether the debt is recourse or nonrecourse; [FN88]

2. whether the fair market value of the property is less or more than the amount of the debt; [FN89] and

3. whether the adjusted basis is less or more than the fair market value of the property and/or debt. [FN90]

The following diagram contains the possible different tax results of the above combinations:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

***18** Thus, if a taxpayer has appreciated property which has a fair market value less than the debt and the debt is nonrecourse, a taxpayer will have more gain to report than if the debt were recourse. This is because the amount realized with a nonrecourse note will equal the amount of the unpaid balance of the note rather than the fair market value of the property--that is, the maximum amount realized when a recourse obligation is satisfied. Therefore, no CODI results to a taxpayer satisfying a nonrecourse obligation with property. [FN91] Because there is no CODI, a taxpayer with nonrecourse debt will not have an opportunity to exclude the gain from income under the CODI exclusion rules. [FN92]

However, if a taxpayer's debt is switched from nonrecourse to recourse and the taxpayer transfers property to the creditor to satisfy the debt, the transfer to the creditor may result in CODI and gain. [FN93] Consider the Riches who owe ***19** $1,000,000 to Easy Loan on a recourse loan. If the Riches transfer their land and building, with a fair market value of $400,000 and an adjusted basis of $100,000, to satisfy the $1,000,000 loan, the Riches will have a gain of $300,000 [FN94] and CODI of $600,000. [FN95] The Riches may exclude the CODI from gross income if one of the CODI exceptions applies; [FN96] however, the gain is usually included in gross income. If the loan were nonrecourse, the reportable gain would have been $900,000 without CODI to exclude from gross income. [FN97]

E. Plan 4--Other Alternatives with Less Potential for Practical Success

1. Like-Kind Exchange

Instead of transferring property to the creditor, a taxpayer should consider an exchange, for like-kind property, of the property subject to liabilities. Normally, an exchange of properties will result in recognition of realized gain or loss. [FN98] However, if properties of like-kind are exchanged, no gain or loss is recognized. An exception exists in that gain may be recognized to the extent that property, which is not of like-kind, is received. [FN99] If a taxpayer transfers property which is ***20** subject to more liabilities than those on the property which the taxpayer/transferor receives, the excess liabilities, less any money paid by the transferor, may result in gain

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recognized to the transferor. [FN100]

Even though the possibility of a like-kind exchange exists for a taxpayer in financial trouble, as a practical matter a like-kind exchange may not solve the taxpayer's financial problems. This is because the debt on the property received by the taxpayer/transferor will have to be repaid with after-tax dollars. [FN101]

2. Incorporation

Some taxpayers might consider transferring their business assets to a corporation in exchange for the corporation's stock. [FN102] The corporation could then transfer the assets to its ***21** creditors, and the cancellation of indebtedness income and gain would be reported by the corporation rather than by the shareholder. [FN103]

Two problems may result from the incorporation. First, the taxpayer/transferor will recognize gain to the extent that the nondeductible liabilities transferred to the corporation exceed the adjusted bases of the transferred assets. [FN104] Obviously, the taxpayer can avoid this result by balancing the liabilities transferred to the corporation against the adjusted bases of assets transferred to the corporation. [FN105]

Secondly, the IRS may argue that the step transaction doctrine applies to the transfer of assets to the corporation and the subsequent transfer of assets by the corporation to ***22** creditors. [FN106] Under this analysis, the income from the corporate transfer to creditors, including gains, would be reported by the taxpayer/shareholder rather than by the corporation. The feasibility of incorporating the business with the liabilities in order to avoid gain to the taxpayer/shareholder will depend upon the specific fact situation.

3. Termination of S Corporation Election

If the taxpayer/debtor is an S Corporation, [FN107] prior to the transfer of assets to a creditor in satisfaction of the debt, the taxpayer/debtor should consider terminating its S Corporation election. [FN108] After the S Corporation election has been terminated, the organization could transfer the assets to its creditor(s) to satisfy the corporation's liability. In most cases, due to the S Corporation termination, the gain and CODI will be reported and taxed at the corporate level and not at the shareholder level. [FN109]

***23** 4. Transfer to Trust

Some taxpayers may attempt to transfer the assets and liabilities to an irrevocable trust with the hope that the trust will have to report the gain and CODI upon the transfer of assets to the creditor(s). [FN110] Contrary to the taxpayer's goal to have the gain so reported, gain results from the transfer of assets and liabilities to an irrevocable trust if the liabilities exceed the taxpayer's adjusted basis in the assets. [FN111] Thus, such a transfer to avoid gain and CODI to the transferor does not appear to be a viable alternative.

An equally undesirable result is achieved by a transfer of a taxpayer's assets and liabilities to a revocable or grantor trust with a subsequent transfer of the assets by the revocable trust to satisfy the liabilities. The gain and/or CODI resulting from the asset transfer by the revocable or grantor trust, under the grantor trust tax rules, will be reported by the taxpayer/settlor creating an undesirable result in most cases. [FN112]

***24** IV. SANITY (OR CLARITY, IF POSSIBLE) AND RELIEF

A. Introduction

The present income taxation system, which in many cases substantially increases the tax burden of financially troubled taxpayers, creates traps for the unwary and has resulted in a search by knowledgeable taxpayers and advisors for maneuvers, as discussed in Section III, which will avoid income taxes from debt restructuring. This

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tax system should be revised to avoid inequities and additional problems for financially distraught taxpayers. [FN113]

B. Inequities

The transfer of appreciated assets by insolvent or bankrupt taxpayers to satisfy liabilities creates an inconsistent result when compared with the straight reduction in debt by bankrupt or insolvent taxpayers without a transfer of assets. In the former case, the debtor/taxpayer has gain and, usually, CODI. [FN114] The CODI may be excluded from gross income, whereas the gain must generally be reported by the debtor/taxpayer. [FN115] In contrast, the debtor/taxpayer with straight debt reduction and no transfer of appreciated property will have only CODI and may have no income to report due to the statutory exclusions. [FN116] Such an inconsistency is simply not justifiable. A better result would provide similar tax treatment of both transaction types.

C. Congressional Relief

1. Proposed Subsection (h)

In its earliest stages, this article contemplated a new, ***25** complex Internal Revenue Code section to resolve the tax problems of restructuring debt and the inequities which result from inconsistent treatment of gain and CODI. However, after drafting several proposed Code sections to resolve the tax problems of inconsistent treatment of those taxpayers who resolve their debts with money or nonappreciated assets compared to those taxpayers who use appreciated assets to settle their debts, [FN117] it became evident that additional sections would only add further complexity to the Code. [FN118]

Therefore, in order to give statutory relief to the affected taxpayers, [FN119] to reduce complexity, to add further certainty, to avoid the mental and transactional gymnastics described in Sections II and III, and to ensure consistent treatment, Congress should consider amending Code section 108 to add the following subsection (h):

Subsection (h) Gain--Discharge of Indebtedness Income

(1) Excludable Gain--For purposes of this Chapter, gain realized from the transfer of property to a seller or lender in partial or full satisfaction of an obligation of the transferor shall be regarded as discharge of indebtedness income to the extent the gain realized would be excluded from gross income under this section if the gain realized were classified as discharge of indebtedness income.

(2) Excess Gain--Gain realized which is not excludable from gross income under paragraph (1) of this subsection shall be treated as gain realized for purposes of section 1001 and other gain provisions of this Chapter.

(3) Allocation--Unless otherwise allocated by the transferor and lender in writing, the fair market value of the property transferred to a lender or seller in partial or full satisfaction of the transferor's obligation shall be allocated first to the principal amount of the outstanding debt and any excess shall be allocated to accrued interest.

***26** (4) Coordination with Discharge of Indebtedness Income--If some discharge of indebtedness income and/or gain realized are to be included in gross income even after the application of subsection (a), then the amount of gain realized to be excluded from gross income under subsections (a) and (h)(1) shall bear the same relationship to excluded discharge of indebtedness income (including gain realized to be excluded) as the total gain realized on the transfer described in paragraph (1) of this subsection bears to the total discharge of indebtedness income (including total gain realized).

2. Explanation of Proposed Subsection (h)

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When a taxpayer transfers property to a lender or seller, in full or partial satisfaction of an obligation, gain realized, if any, on the transfer will be subject to the exclusionary rules of Code subsections 108(a), (d), and (e). In addition, to the extent excluded from gross income, the gain realized will be regarded as discharge of indebtedness income. [FN120] The gain realized, to the extent not excluded from gross income under the Code section 108 exclusionary rules, will retain its status as gain realized [FN121] and will be subject to capital gain, nonrecognition, depreciation recapture, and other gain rules and analyses. [FN122]

For taxpayers who are not in bankruptcy, if gain realized and CODI exceed the amount of the taxpayer's insolvency, some of the gain realized and CODI will be subject to exclusion while other gain realized and CODI will be included in gross income during the same taxable year. [FN123] In this case, in order to determine the amount of gain realized excluded from gross income, the gain realized will be proportionately excluded from gross income based upon the following formula:

Total Gain Realized/Total Gain Realized and CODI = Gain to be excluded under Code § 108/Income to be excluded under Code § 108

*27 For example, if the Riches, who are not in bankruptcy, transfer an asset with a fair market value of $400,000 and an adjusted basis of $100,000 to satisfy a recourse obligation of $1,000,000, the Riches will have gain realized of $300,000 ($400,000 fair market value less $100,000 adjusted basis) [FN124] and CODI of $600,000 (difference between $1,000,000 obligation and $400,000 fair market value of property transferred to satisfy the obligation). [FN125] Assume that the Riches are insolvent to the extent of $796,000. The Riches can only exclude the gain realized ($300,000) and CODI ($600,000) to the extent of insolvency ($796,000). [FN126] Paragraph (4) of proposed subsection (h) would allocate the exclusionary amount as follows:

Total Gain Realized ($300,000)/Total Gain Realized ($900,000) and CODI = ($265,000) Gain Realized to be excluded/($796,000) Income (Gain Realized and CODI to be excluded)

Gain Realized to be excluded = $265,000

CODI to be excluded = $531,000 ($796,000 - $265,000)

The remainder of the gain realized [$300,000 (total gain realized) less $265,000 (gain realized excluded) = $35,000] will be subject to the normal tax rules for gain realized--capital gain, section 1231, depreciation recapture, and nonrecognition provisions, [FN127] and the remaining CODI ($600,000 -$531,000 = $69,000) will be included in gross income under the general rule of the Kirby Lumber case. [FN128]

Without proposed subsection (h), the Riches would have $600,000 of CODI which would be totally excluded from *28 gross income, and they would recognize gain of $300,000. Thus, unless the indebtedness is qualified farm indebtedness and the Riches meet the requirements of Code section 108(g), proposed subsection (h) would allow the Riches to exclude an additional $196,000 from gross income and, as a result, include only $104,000 in gross income as gain realized and/or CODI.

A taxpayer, who had cancelled the $1,000,000 debt with a $100,000 cash payment and was insolvent to the extent of $796,000, would be allowed to exclude $796,000 of the $900,000 in CODI from gross income. The same result would be achieved when appreciated property satisfies the $1,000,000 obligation, [FN129] thus providing more consistent treatment under proposed subsection (h) than under the present CODI/gain realized rules.

3. Implications of Proposed Subsection (h)

The enactment of subsection (h) would result in consistent treatment for CODI and gain realized for taxpayers who could exclude CODI and/or gain realized from gross income if one of the statutory exclusions in Code

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section 108(a), (d), or (e) applies. Financially troubled taxpayers, under proposed subsection (h), obtain a new federal income tax start, thereby achieving one of the purposes behind the enactment of Code section 108. [FN130]

The effect on tax revenues should be minimal because the affected taxpayer must usually be in bankruptcy, be insolvent, or have status as a qualified farmer in order to exclude the gain from gross income under proposed subsection (h). [FN131] Thus, the IRS will be relieved of attempts to collect taxes from taxpayers who have few if any assets other than exempt assets and assets subject to security interests prior to the IRS tax lien. Consequently, taxpayers should be relieved from the ***29** financial and psychological burdens of owing taxes while lacking the funds to pay them.

Some tax purists could argue that subsection (h) would result in a double tax benefit to taxpayers who own depreciable property. The first benefit is represented by the depreciation deduction, [FN132] and a second tax benefit would be realized by excluding gain, as CODI, when the depreciable property is transferred to a creditor to satisfy the taxpayer's obligation. [FN133] However, a similar double tax benefit is available to taxpayers who borrow funds to pay business or production-of-income expenses and later have the loan reduced or cancelled. The taxpayer will first deduct business or production-of-income expenses [FN134] which reduce taxable income and later, when the loan is reduced or cancelled, the CODI may be excluded from gross income. [FN135]

Tax administrators may argue that subsection (h) will result in income tax avoidance by a plethora of tax shelter investors when a tax shelter partnership is insolvent. Accordingly, most gain would be excluded from gross income under the proposed subsection. Practically, however, because the exclusionary tests of Code section 108 are applied at the partner level and not at the partnership level [FN136] and because many tax shelter investors are required to meet certain net worth requirements before committing funds to the tax shelter, [FN137] few tax shelter investors should be insolvent or able to file for bankruptcy. Thus, most of these investors would not qualify under the exclusionary requirements of Code section 108. Therefore, gain from the transfer of the property by a tax shelter or other partnership to a creditor, in partial or full satisfaction ***30** of an obligation, will be included in a partner's gross income.

V. CONCLUSION

The inequities created by the difference in treatment between gain realized, which is included in gross income, and cancellation of indebtedness income, which can or may be excluded in many cases, may be alleviated through creative and proper tax planning. Enactment of a statutory provision where gain realized is subject to similar exclusionary rules as CODI should result in more consistent treatment for financially troubled taxpayers. Because most of these taxpayers are arguably levy-proof, no substantial loss of revenue would result.

Furthermore, enactment of the proposed legislation to treat gain realized as CODI for some taxpayers will give financially troubled taxpayers a fresh tax start, similar to the fresh start obtained in bankruptcy, and relief from a tremendous emotional burden. The effect of changing the tax rules on gain realized in debt restructuring transactions should also be minimal to the United States Treasury because collection of the taxes levied against these taxpayers is frequently impracticable.

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FN1. The Uniform Commercial Code contains three definitions of insolvency:

(a) a person is unable to pay his, her, or its debts as they become due. 11 U.S.C. § 303(h)(1) (1986).

(b) a person fails to pay his, her, or its debts in the ordinary course of business.

(c) a person's liabilities exceed the fair market value of a person's assets, I.R.C. § 108(d)(3) (1986); 11 U.S.C. §

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 226

101(31) (1986).

U.C.C. § 1-201(23).

The latter definition is used to calculate the insolvency or negative net worth of the Riches, although the Riches are probably also insolvent under the other insolvency definitions. See also Kreps v. Comm'r, 351 F.2d 1 (2d Cir. 1965).

FN2. Debtors have asserted various causes of action against creditors, including, but not limited to, the following:

a. breach of a confidential relationship;

b. breach of a covenant of fair dealing; K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985); see also Annotation, Bank's Liability for Breach of Implied Contract of Good Faith and Fair Dealing, 55 A.L.R. 4th 1026 (1987).

c. economic duress;

d. fraud (actual and constructive);

e. intentional interference with a business relationship (existing and potential);

f. intentional misrepresentation;

g. negligent misrepresentation;

h. breach of contract;

i. negligence;

j. reduction in value of assets--breach of fiduciary duty/breach of contract.

The Wall Street Journal reported that lender liability has risen dramatically in the last few years. Wall St. J., April 7, 1988, at 7, col. 1. For a discussion of theories farm debtors may have against their lenders, see Bahls, Termination of Credit for the Farm or Ranch: The Theories of Lender Liability, 48 MONT. L. REV. 213-66 (1987).

FN3. The following table shows that bankruptcy filings have increased by more than 50% in the last five years.

Filings, by Chapter of the Bankruptcy Code June 30, 1982 through June 30, 1987

Year	Total	7	11	Chapter 12 [FN*]	13	Other
1982	367,866	255,095	14,058		98,705	8
1983	374,734	251,319	21,206		102,201	8
1984	344,275	232,778	20,023		91,460	13
1985	364,536	244,647	21,420		98,452	17
1986	477,856	332,675	24,442		120,726	13

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1987	561,278	397,548	22,564	4,824	136,300	42

FN* Chapter 12, which deals with family framer debt adjustment, became effective November 26, 1986.
Source: 1987 ANN. REP. OF THE ADMIN. OFF. OF THE UNITED STATES CTS. 10, 100-01.

For a discussion of the farm crisis and its effects on families, see, In Iowa, Mental Anguish Still Racks Families, Taxes Social Workers, Even as Farm Crisis Abates, Wall St. J., May 18, 1988, at 70, col. 1.

FN4. See infra notes 75 and 77 and accompanying text (discussing tax collection activities of the Internal Revenue Service (IRS)).

FN5. References to the Internal Revenue Code are to the Internal Revenue Code of 1986 (as amended).

FN6. United States v. Kirby Lumber Co., 284 U.S. 1 (1931) (held that a taxpayer who had purchased bonds for less than the face amount had gross income to the extent that the face amount of the bonds exceeded the amount paid for the bonds).

FN7. Id.

FN8. See infra notes 13-17 and accompanying text (discussing the exceptions to the general rule).

FN9. The Riches owe Easy Loan principal of $1,000,000 and interest of $150,000. The transfer of the land and building with a fair market value of $400,000 to Easy Loan in satisfaction of the $1,150,000 debt will result in CODI of $750,000 (difference between debt and fair market value of asset transferred to the creditor), assuming the interest is included in the $1,150,000 debt for CODI purposes. Accrued interest is excluded from gross income if the interest would be deductible to the debtor if paid. I.R.C. § 108(e)(2) (1986). If this accrued interest is eliminated from gross income, then the interest should be excluded from both the CODI and insolvency calculations.

FN10. The Riches owe Friendly Bank principal of $500,000 and interest of $75,000. The payment of $200,000 in cash to Friendly Bank in full satisfaction of the $575,000 debt will result in CODI of $375,000. See supra note 9 (analysis of the effect of interest on the CODI and insolvency calculations).

FN11. United States v. Kirby Lumber Co., 284 U.S. 1 (1931).

FN12. Astoria Marine Constr. Co. v. Comm'r, 12 T.C. 798 (1949); Lakeland Grocery Co. v. Comm'r, 36 B.T.A. 289 (1937).

FN13. Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926) (United States Supreme Court held that no income resulted when a taxpayer, who had borrowed German marks and lost money on the transaction, repaid the loan with German marks which cost less than the original German marks borrowed). The Ninth Circuit Court of Appeals has refused to follow Kerbaugh-Empire. Vukasovich, Inc. v. Comm'r, 790 F.2d 1409 (9th Cir. 1986).

FN14. Edwards v. Comm'r, 19 T.C. 275 (1952); Clem v. Campbell, 62-2 USTC (CCH) ¶9786 (N.D. Tex. 1962); Bosse v. Comm'r, 29 T.C.M. 1772 (1970).

FN15. Helvering v. American Dental Co., 318 U.S. 322 (1943). The American Dental Co. case was subsequently limited to its facts by the United States Supreme Court. Comm'r v. Jacobson, 336 U.S. 28 (1949).

FN16. The Senate Finance Committee stated that I.R.C. § 108 (1986) was amended because the tax rules contained in the Bankruptcy Act were repealed by Pub. L. No. 95-598, 92 Stat. 2549-2688 (1978). Furthermore, the Committee intended to give bankrupt and insolvent taxpayers a fresh start. S. REP. NO. 1035, 96th Cong. 2d Sess. 620, 624

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(1980).

FN17. Prior to the 1980 amendment, I.R.C. § 108 (1954), (as amended), read as follows:

> No amount shall be included in gross income by reason of the discharge, in whole or in part, within the taxable year, of any indebtedness for which the taxpayer is liable, or subject to which the taxpayer holds property, if--
>
> (1) the indebtedness was incurred or assumed--
>
> (A) by a corporation, or
>
> (B) by an individual in connection with property used in his trade or business, and
>
> (2) such taxpayer makes and files a consent to the regulations prescribed under section 1017 (relating to adjustment of basis) then in effect at such time and in such manner as the Secretary by regulations prescribes.

In such case, the amount of any income of such taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income, and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction.

The 1980 amendment to section 108 under Pub. L. No. 96-589, § 2(a), 94 Stat. 3389 (1980) divided section 108 into five subsections. The general exclusion rules are in subsection (a). Subsection (b) contains the reduction of tax attributes. Under subsection (c), a taxpayer could elect to exclude qualified business indebtedness from gross income (this exclusion was repealed by the Tax Reform Act of 1986). Subsection (d) defines the terms and contains special rules, and subsection (e) explains the application of the discharge of indebtedness exceptions.

FN18. I.R.C. §§ 108(a)(1)(A) and (d)(2) (1986).

FN19. I.R.C. §§ 108(a)(1)(B), (a)(3), (d)(1), and (d)(3) (1986).

FN20. I.R.C. § 108(e)(2) (1986). This exception generally applies to cash basis taxpayers because in order for no CODI to result to the taxpayer under I.R.C. § 108(e)(2) (1986), the taxpayer must have received a deduction if the discharged item had been paid. Examples of items which, if paid by a cash basis taxpayer, will result in a deduction to a taxpayer include compensation, interest and rent. Query whether the result would be the same for discharge of personal interest which is no longer deductible, subject to phase out rules. I.R.C. § 163(h)(1) and (6) (1986). If an accrual basis taxpayer has deducted an item and the item is subsequently cancelled or forgiven, the item should be subject to the tax benefit rule, I.R.C. § 111 (1986), and not the CODI rules of I.R.C. § 108 (1986). In situations where the accrued item has been added to the principal owed by the taxpayers and the loan is nonrecourse, the Tax Court has held that the amount realized includes the accrued item and that the tax benefit rule is inapplicable. Allan v. Comm'r, 86 T.C. 655 (1986).

FN21. I.R.C. § 108(e)(5) (1986).

FN22. I.R.C. § 108(g) (1986) which was added by the Tax Reform Act of 1986; Pub. L. No. 99-514, § 405(a), 100 Stat. 2224 (1986), effective for discharge of indebtedness occurring after April 9, 1986. In order to apply the solvent farmer exclusion rules, the lender must be a qualified person, which, now includes federal, state or local governments as well as agencies and instrumentalities of such governments. I.R.C. § 108(g)(3) (1986). The Technical and Miscellaneous Revenue Act of 1988 expands the definition of 'qualified person' to include federal, state or local governments or affiliates and limits the exclusion from CODI for qualified farmers to the tax attributes and adjusted basis in depreciable property, farm land, or other business or investment property. § 1004 of the Technical and

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Miscellaneous Revenue Act of 1988, H. Rep No. 4333, 100th Cong., 2d Sess. (1988).

FN23. Id.

FN24. I.R.C. §§ 108(b) and 1017 (1986).

FN25. Asofsky & Tatlock, Bankruptcy Tax Act Radically Alters Treatment of Bankruptcy and Discharging Debts, 54 J. TAX'N 106-11 (1981); Bibler & Bloethe, Discharge of Indebtedness--Tax Planning Alternatives for the Individual Taxpayer, 7 J. OF AGRIC. TAX'N AND LAW 233-56 (1985).

FN26. See Section III of this article.

FN27. See calculations at supra notes 9 and 10. The amount of federal income taxes on this income of $1,125,000 will depend upon a variety of factors including, but not limited to, net operating losses available to offset this income, other deductions, other income, and filing status.

FN28. See supra notes 13-18 and accompanying text.

FN29. Nichols v. Comm'r, 141 F.2d 870 (6th Cir. 1944); Helvering v. Missouri State Life Ins. Co., 78 F.2d 778 (8th Cir. 1934).

FN30. I.R.C. § 108(e)(2) (1986). See discussion supra note 20.

FN31. Compare I.R.C. § 111 (1986) (unpaid interest of an accrual basis taxpayer which is cancelled should be included in gross income under the tax benefit rule) with Allan v. Comm'r, 86 T.C. 655 (1986) (accrued interest added to principal should be included in the amount realized for nonrecourse loans and is not subject to the tax benefit rule).

FN32. The liability for the interest excluded under I.R.C. § 108(e)(2) (1986) should not be included in the insolvency calculations because this interest is not included in the CODI calculations and, thus, could result in a double benefit to the taxpayer: one benefit because the interest is not CODI and a second benefit from increasing the amount of the taxpayer's insolvency and potential CODI exclusion.

FN33. 'Insolvency' is defined as 'the excess of liabilities over the fair market value of assets.' I.R.C. § 108(d)(3) (1986). See also supra note 1 for definitions of 'insolvency.' Assets, such as the Riches' personal residence, which are exempt from levy by creditors are excluded from the asset side of the insolvency calculation. Rufus S. Cole, 42 B.T.A. 1110 (1940); Estate of B. M. Marcus, 44 T.C.M. (P-H) ¶75,009 (1975).

FN34. The insolvency exclusion is limited to the amount of the insolvency which is calculated before the discharge occurs. I.R.C. §§ 108(a)(1)(B) and (3), and (d)(3) (1986).

FN35. United States v. Kirby Lumber Co., 284 U.S. 1 (1931).

FN36. See Kenan v. Comm'r, 114 F.2d 217 (2d Cir. 1940). The creditor must report the acquisition or abandonment to the Internal Revenue Service (IRS) on Form 1099-A. See I.R.S., Sales and Other Disposition Assets, 1987 Pub. 544 (IRS position on abandonments and acquisitions of property by creditors to satisfy a debt obligation).

FN37. See supra note 9 and accompanying text for an analysis of the CODI effect.

FN38. Nonrecourse means that the creditor (lender) is not entitled to a personal judgment (recourse) against the debtor but can only recover the property which secures the loan; thus, the debtor has no personal liability. Treas. Reg. § 1.1001-2(a) and (c) (1980).

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FN39. The gain realized is equal to:

Amount realized	=	$1,150,000	(amount of the nonrecourse debt--I.R.C. s 7701(g) (1986); Comm'r v. Tufts, 461 U.S. 300 (1983))
Less Adjusted Basis	=	$ 100,000	(I.R.C. ss 1011, 1012, and 1016 (1986))

Gain Realized	=	$1,050,000	

The amount realized may be reduced by the accrued interest if the fair market value of the land and building is less than the principal amount of debt. See supra note 29 and accompanying text. Even if the gain includes the interest, the interest should be deductible subject to the personal interest deduction limitation (I.R.C. § 163(h) (1986)), investment interest deduction limitation (I.R.C. § 163(d) (1986)), and the passive loss rules of I.R.C. § 469 (1986).

FN40. Recourse means the debtor has personal liability. U.C.C. § 3-414(1) (1987). The lender may obtain a personal judgment against the debtor. For examples of tax effects of recourse liability, see Treas. Reg. § 1.1001-2(a) and (c) (1980).

FN41. Treas. Reg. §§ 1.1001-2(a)(2), (b), and (c) ex. 8 (1980).

FN42. Id. But see supra notes 5 and 33 for a discussion of the interest adjustment which may reduce the amount of gain realized.

FN43. Texas Gas Distrib. Co. v. Comm'r, 3 T.C. 57 (1944).

FN44. Evidently, in order to avoid the CODI exclusions and a conflict with other court decisions and Treasury Department regulations, the Treasury Department withdrew its acquiescence on June 15, 1987 in Texas Gas Distrib. Co. v. Comm'r, 3 T.C. 57 (1987) (revised action on decision, dated June 15, 1987). The amount realized upon the transfer of property to satisfy a nonrecourse note is not less than the amount of the debt even if the fair market value of the property is less than the debt. I.R.C. § 7701(g) (1986).

FN45. Frank C. Davis, Jr., 88 T.C. 122 (1987).

FN46. See supra notes 18-23 and 38-41 and accompanying text.

FN47. I.R.C. §§ 1001(a) (realization) and (c) (recognition of gain), 1222 (capital gains), 1(j) (capital gains tax rates), 1245 and 1250 (depreciation recapture), 1231 (ordinary or capital gains), 1031 (like kind exchanges), 1033 (involuntary conversions), 1034 (rollover of gain on principal residence), and 121 (1986) (exclusion of gain on sale of principal residence by some taxpayers).

FN48. For a discussion of installment payment agreements, see SALTZMAN, IRS PRACTICE AND PROCEDURE ¶15.05 (1981) [hereinafter, SALTZMAN].

FN49. 11 U.S.C. §§ 507(a)(6), 524(a), 523(a)(1)(A) and (B). See SALTZMAN, supra note 48, ¶16.11, for further discussion of bankruptcy effects on income tax liabilities and liens. Some individual taxpayers file for bankruptcy primarily to trap in the bankruptcy estate, which is a separate taxpayer, the income tax resulting from the gain recognized and/or CODI on the transfer of property to a creditor to satisfy the taxpayer's debt. I.R.C. §§ 1398(a) and (c) (1986). However, if there is no equity in an asset, the bankruptcy trustee may abandon the asset to the debtor who subsequently transfers the asset to the creditor. Some taxpayers believe that the abandonment results in gain to the bankruptcy estate and an adjusted basis in the abandoned property to the taxpayer equal to the amount of the

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 231

indebtedness against the abandoned property. This argument is based upon the negative implication of I.R.C. § 1398(f)(2) (1986) that a transfer from the bankruptcy estate to the debtor in the termination of the bankruptcy estate is not a disposition which will result in gain or loss recognized; thus, an abandonment by the bankruptcy trustee, which is not a termination, should result in gain or loss recognition to the bankruptcy estate subject to other nonrecognition provisions. The fallacy of this argument is that an abandonment for bankruptcy purposes does not result in a disposition or transfer for income tax purposes.

FN50. I.R.C. § 7122 (1986).

FN51. See SALTZMAN, supra note 48, ¶15.07 (discussing offers in compromise).

FN52. See supra note 49.

FN53. I.R.C. § 104(a)(2) (1986). The excludable recovery for personal damages may be either through a judgment or settlement. Id.

FN54. Rev. Rul. 75-45, 1975-1 C.B. 47.

FN55. Rev. Rul. 84-108, 1984-2 C.B. 32.

FN56. See supra note 2.

FN57. Threlkeld v. Comm'r, 87 T.C. 1294 (1986).

FN58. Id.

FN59. Vincent v. Comm'r, 219 F.2d 228 (9th Cir. 1955).

FN60. No gain will be realized if the damages incurred are less than the debtor's adjusted basis. I.R.C. § 1001(a) (1986). The adjusted basis in the property will be reduced by the damages received. I.R.C. § 1016(a) (1986).

FN61. Id.

FN62. Rev. Rul. 85-98, 1985-2 C.B. 51.

FN63. Priv. Ltr. Rul. 85-47-025 (1985). Although under I.R.C. § 6110(j)(3) (1986) private letter rulings have no precedential effect, these rulings may be given some weight if the IRS attempts to take a contrary position. Rowan Cos., Inc. v. United States, 452 U.S. 247 (1981).

FN64. Rev. Rul. 85-98, 1985-2 C.B. 51.

FN65. Id.

FN66. Id.

FN67. If no allocation of damages is pled or contained in the settlement agreement, a judge's decision, or in a jury verdict, then the allocation will be based upon the facts established in the case. See supra note 63.

FN68. I.R.C. § 61 (1986). Comm'r v. Glenshaw Glass Co., 348 U.S. 426 (1955) (everything received is includable in gross income except to the extent that a statutory or judicial exclusion exists).

FN69. I.R.C. § 1001(a) (1986). Gain realized from settlements or lawsuits will be included (recognized) in gross

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income unless a nonrecognition provision applies. I.R.C. § 1001(c) (1986). Nonrecognition I.R.C. sections include § 1031 (like-kind exchange), § 1033 (involuntary conversion), § 1034 (sale of principal residence), and § 121 (election by taxpayer, aged 55 or over, to exclude up to $125,000 of gain from gross income).

FN70. See supra notes 47-63 and accompanying text.

FN71. For a discussion of possible gain, see supra notes 37-41 and accompanying text.

FN72. See supra notes 13-20 and accompanying text (CODI exclusions).

FN73. Capital losses can be used to offset capital gains plus the lesser of $3,000 or taxable income. I.R.C. § 1211(b) (1986). Thus, capital losses in excess of capital gains will offset a maximum of $3,000 of ordinary gain or CODI each year. Capital losses not used are carried forward. I.R.C. § 1212 (1986).

FN74. Tax credits which may be used to reduce taxes from the gain or CODI include carryovers of investment tax credit. I.R.C. § 39(d) (1986). An investment tax credit is generally not available for property placed in service after December 31, 1985. I.R.C. § 49(a) (1986).

FN75. After the federal income tax is assessed under I.R.C. § 6203 (1986), the IRS will send a notice and demand for payment of the tax. I.R.C. § 6303 (1986). If the taxpayer fails to pay the tax within 10 days after the notice and demand is sent, the IRS may levy on all of the taxpayer's property or rights to property, unless the property or right is exempt. I.R.C. §§ 6331, 6334 (1986) (for levy and exempt property, respectively).

FN76. 11 U.S.C.A. § 507(a)(7)(A)(i) (West Supp. 1987).

FN77. See supra note 75.

FN78. I.R.C. § 1041(a) (1986).

FN79. I.R.C. § 1041(b) (1986).

FN80. If the loan is nonrecourse, then the transferee will have only gain to report and no CODI. If the loan is recourse, then there may be gain or loss and/or CODI. See supra notes 38-41 and the accompanying text (discussion of the tax consequences to the transferee spouse).

FN81. See supra notes 18-25 and accompanying text (discussing of these exceptions).

FN82. A spouse is not liable for the other spouse's federal income taxes unless a joint federal income tax return is filed. I.R.C. § 6013 (1986). However, even if a joint return is filed, an innocent spouse may not be liable for unreported items. I.R.C. § 6013(e) (1986). A transfer of property by one spouse to the other spouse after tax liability has accrued may result in transferor liability to the transferee spouse. See SALTZMAN, supra note 48, at ¶¶17.01-17.06.

FN83. Because the transferor is not liable for federal income taxes, except to the extent of federal income taxes on his or her share of CODI which is not excluded from gross income under I.R.C. § 108 (1986), the IRS will be unable to levy on the transferor's assets unless the step-transaction doctrine applies. See supra note 75 and accompanying text (discussion of the tax collection procedures).

FN84. For a complete discussion of the different theories behind the step transaction doctrine, see McDonald's Restaurants, Inc. v. Comm'r, 688 F.2d 520 (7th Cir. 1982). See also Gutkin, Step Transactions, 9 N.Y.U. INST. ON FED. TAX'N 1219 (1951).

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FN85. Glenn E. Edgar, 56 T.C. 717, 738-39 (1971). If a tax return is timely filed for the transfer between the two spouses and more than 3 years has expired since the latter of the filing of the tax returns or the due date of the returns, the statute of limitations has expired for the transaction between the two spouses unless there is fraud or a substantial omission from gross income. I.R.C. §§ 6501(a) and (c) (1986).

FN86. Id.

FN87. Id.

FN88. If a debt is recourse, then the transferor may have gain or loss and/or CODI. See supra notes 40 and 41 and accompanying text. Satisfaction of nonrecourse debt may result in gain or loss, but no CODI, because the amount realized on nonrecourse debt satisfaction is never less than the amount of the debt. See supra notes 38 and 39 and accompanying text.

FN89. See supra notes 40 and 41 and accompanying text. This factor only influences recourse debt since there may be CODI if the FMV is less than the debt.

FN90. If the adjusted basis is less than the FMV and debt, the transferor will have gain to the extent of the excess. The amount of the gain will depend upon whether the debt is recourse or nonrecourse. See supra notes 38-41 and accompanying text and infra note 91 and accompanying text. Loss will result if the fair market value (recourse) or debt (nonrecourse) is less than the adjusted basis. See supra notes 38-41 and accompanying text.

FN91. I.R.C. § 7701(g) (1986) requires the amount realized to be not less than the amount of the unpaid debt. See also Comm'r v. Tufts, 461 U.S. 300 (1983).

FN92. CODI may be excluded under one of the various CODI exceptions. See supra notes 18-22 and accompanying text. Gain may be excluded only if a nonrecognition provision of the I.R.C. applies. See supra note 69 (some of the nonrecognition provisions).

FN93. See supra notes 40 and 41 and accompanying text. The change from nonrecourse to recourse liability could increase the risk to the taxpayer since the note holder could pursue the taxpayer's other assets if the property subject to the liability did not satisfy the taxpayer's obligations.

FN94. Id. Gain is equal to the difference between the fair market value of $400,000 and an adjusted basis of $100,000. I.R.C. § 1001(a) (1986). A contract seller may have gain to report if the seller reported the sale on the installment method. I.R.C. § 453B(a) (1986). But see I.R.C. § 1038 (1986) for nonrecognition rules on all or part of the gain. A lender may have a bad debt deduction for any tax loss incurred due to the transfer of property and/or cancellation of debt. I.R.C. § 166(a) (1986).

FN95. See supra note 9 for a discussion of CODI.

FN96. See supra notes 18-22 and accompanying text.

FN97. I.R.C. § 1001(a) and (c) (1986).

FN98. The gain realized of $900,000 equals the amount realized ($1,000,000) which is not less than the amount of the debt, less the adjusted basis of $100,000. See supra notes 88-91.

FN99. I.R.C. § 1031(a) (1986). 'Like-kind' refers to the 'nature or character of the property and not to its grade or quality.' Treas. Reg. § 1.1031(a)-1(b) (as amended in 1967). Thus, unimproved real estate for improved real estate will qualify as like-kind property. Treas. Reg. § 1.1031-(a) (as amended in 1967). The amount of liabilities assumed by the transferee, or the amount of liabilities to which the property is subject, is treated as money received by the

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 234

transferor. I.R.C. § 1031(d) (1986). Thus, if the transferor realized a gain on the like-kind exchange and receives nonlike-kind property, the transferor will have to recognize gain to the extent of the lesser gain or the amount treated as money received unless the transferor transfers money to the transferee and/or assumes liabilities on the property received in the exchange (or takes property subject to liabilities) at least equal to the liabilities on the property transferred. Treas. Reg. § 1.1031(d)-2 (1956).

FN100. I.R.C. § 1031(d) (1986). See also Treas. Reg. § 1.1031(d)-2 (1960).

FN101. For example, if the Riches exchanged their land and building (FMV = $400,000, adjusted basis = $100,000, subject to First Credit Union's mortgage of $300,000) for a parking lot with a fair market value of $800,000 and subject to a mortgage of $700,000, the Riches will pay the principal on the mortgage over a period of years with after-tax dollars unless the parking lot is depreciable. Assuming that the Riches are in a 28% tax bracket and the parking lot is not depreciable, the Riches will need $972,222 before federal income taxes to pay off the mortgage. If the Riches are in the 28% tax bracket and the Riches can depreciate $650,000 of the parking lot cost, only $719,444 in before-tax dollars will be required to fully pay the Riches' $700,000 mortgage.

FN102. A transfer of assets is tax free to the transferor if property is transferred in exchange for stock and securities and the transferor controls the corporation immediately after the transfer. I.R.C. § 351(a) (1986). Numerous pitfalls to a tax free incorporation may occur. For example:

a. Services are not property; thus, stock and securities issued for services will not be received tax free by the transferor. I.R.C. §§ 351(d)(1), 83(a) (1986).

b. If the corporation is an investment company and the transfer results in diversification to the transferor, then the transfer will not be subject to the nonrecognition provisions of I.R.C. § 351(a). I.R.C. § 351(e)(1) (1986); Treas. Reg. § 1.351-1(c) (1967).

c. If the transferor incorporates a going concern and has prepaid expenses and/or accumulated accounts receivable prior to incorporation, the IRS may reallocate the income and/or deduction items. Rev. Rul. 80-198, 1982-2 C.B. 113.

d. If the corporation is an existing corporation, the transferor may not have control of the corporation immediately after the transfer. Control is defined as 80% of the voting power of the corporation plus 80% of each class of non-voting stock. I.R.C. § 368(c) (1986); Rev. Rul. 59-259, 1959-2 C.B. 115.

See BITTKER & EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ch. 3 (5th Ed. 1987), (thorough discussion of tax-free incorporations).

FN103. The corporation has the same adjusted basis that the shareholder had in property transferred to the corporation, plus any gain recognized to the transferor/shareholder. I.R.C. § 362(b) (1986). Therefore, when the corporation transfers the property to the creditor, the analysis of the tax effects to the corporation will be similar to the Riches' analysis of their transfer to creditors. See supra notes 38-44 and accompanying text.

FN104. The general rule of I.R.C. § 357(a) (1986) results in the liabilities not being treated as money or other property; thus, the liabilities would not trigger the recognition of gain under I.R.C. § 351(b) (1986). However, I.R.C. § 357(c) (1986) requires a taxpayer to report the excess of the nondeductible liabilities over the adjusted basis of transferred properties as gain. The transferor's adjusted basis in the stock or securities received in the exchange is reduced by the amount of the liabilities which the corporation takes subject to, or by the amount which the corporation assumes. I.R.C. § 358(d)(1) (1986). If the principal purpose of the assumption of liabilities by the corporation was not a business purpose or was to avoid federal income tax liability on the transfer, then all of the liabilities assumed or acquired by the corporation would be regarded as money received by the transferor. I.R.C. § 357(b) (1986). The latter rule takes precedence over the liabilities in excess of basis rule. I.R.C. § 357(c)(2)(A) (1986).

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FN105. The balancing of liabilities and adjusted bases of assets can occur in one of several ways. For example:

a. The transferor may retain the liabilities instead of transferring them to the corporation.

b. The transferor may contribute money or assets with sufficient adjusted bases to offset the liabilities acquired by the corporation. The contribution of the transferor's promissory note to the corporation will not increase the transferor's basis since the transferor has a zero basis in that promissory note. Rev. Rul. 68-629, 1968-2 C.B. 154.

c. The transferor may withhold property which is subject to liabilities in excess of basis and lease such property to the corporation.

FN106. See supra notes 84-87 and accompanying text (discussion of the application of the step-transaction doctrine).

FN107. The income and deduction items of an S Corporation, in most cases, flow through the S Corporation to its shareholders in proportion to their percentage of stock ownership; thus, an S Corporation is not subject to income tax unless it has built-in gains (I.R.C. § 1374) (1986) or excess net passive income (I.R.C. § 1375) (1986). An S Corporation is a small business corporation, as defined in I.R.C. § 1361(b) (1986), which, with its shareholders, has elected under I.R.C. §§ 1362(a) and (b) (1986) to be treated as an S Corporation. For a thorough discussion of S Corporations, see EUSTICE & KUNTZ, FEDERAL INCOME TAXATION OF S CORPORATIONS (2d ed. 1985).

FN108. If the S Corporation election is not terminated, then the gain and CODI upon the transfer of assets to the creditor will be passed through the S Corporation and reported by the S Corporation's shareholders. See supra note 107. The exclusionary tests of I.R.C. § 108(a) and (b) are applied at the corporate level and not at the shareholder level. I.R.C. § 108(d)(7) (1986). An S Corporation election continues until the election is terminated through revocation (I.R.C. § 1362(d)(1) (1986)); the corporation ceases to be a small business corporation (I.R.C. § 1362(d)(2) (1986)); or for three consecutive years the corporation has subchapter C earnings and profits and more than 25% of the corporation's gross receipts are passive investment income (I.R.C. § 1362(d)(3) (1986)).

FN109. See supra notes 37-43 and accompanying text. But see supra note 77 and accompanying text (discussing the step-transaction doctrine). If the transfer to the creditor occurs after the S Corporation election is terminated, but during the same taxable year as the corporation's termination is effective, the gain and CODI will be allocated on a daily basis. I.R.C. §§ 1362(e)(1) and (2) (1986). Thus, the shareholders will be required to report the portion of the gain and CODI allocated to the short S Corporation taxable year. However, if the corporation and shareholders agree, the S Corporation taxable year will end on the date of termination; therefore, the CODI and gain will be trapped on the regular corporation's tax return because the transfer of assets and debt restructuring occurred in a taxable year when the S Corporation election was not in effect. I.R.C. § 1362(e)(3) (1986). The regular corporation may exclude the CODI if one of the section 108 exceptions applies (see supra notes 18-23) and the gain may be excluded if a nonrecognition section applies (see supra note 69) or if the transaction can be structured to avoid gain. See section III of this article. Query whether the IRS may argue that if the debt is nonrecourse, then a sale or disposition occurs when the S Corporation election is terminated. See infra note 112 (discussion of the occurrence of a sale or disposition when a revocable trust is converted to an irrevocable trust).

FN110. The IRS may argue that the step-transaction doctrine applies or that the transfer to the trust lacks substance. The Tax Court rejected these arguments in Glenn E. Edgar, 56 T.C. 717 (1971); however, if the transaction has no purpose except to avoid income taxes, a court might find that the transfer did lack substance or might apply the step-transaction doctrine. See McDonald's Restaurants, Inc. v. Comm'r, 688 F.2d 520 (7th Cir. 1982) (discussion of the step-transaction doctrine).

FN111. The trust will report and be taxed on the gain realized unless the trust is a grantor trust (I.R.C. §§ 671-78) (1986); the trust is required to distribute its income to the beneficiaries; or it does distribute the income to its

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beneficiaries and the gain is allocable to the income beneficiaries rather than the trust. I.R.C. §§ 652, 662 (1986); Treas. Reg. § 1.1001-2(a) (1980); Diedrich v. United States, 457 U.S. 191 (1982) (held that taxpayer who transferred assets to children who in turn paid taxpayer's gift taxes recognized gain to the extent that gift taxes exceeded transferor's adjusted basis). If the transfer to the creditors occurs within two years after the taxpayer's transfer of assets to the trust and the trust is taxable on the gain realized, then the trust may pay an income tax on its transfer at the taxpayer's maximum rate. I.R.C. § 644 (1986). The transferor may avoid recognition of gain through proper tax planning. See supra note 105 (ways to balance liabilities and adjusted bases).

FN112. A transfer of assets and liabilities to a revocable trust will not trigger tax consequences to the transferor because the transferor/taxpayer is regarded as the owner of the trust for most tax purposes. Rev. Rul. 77-402, 1977-2 C.B. 222; Madorin v. Comm'r, 84 T.C. 667 (1985). Furthermore, when the revocable trust transfers assets to satisfy liabilities, the gain and CODI will pass through to the settlor (transferor) of the trust. I.R.C. § 674 (1986). If the transferor releases the power(s) which makes the transferor the owner of the trust, the transferor may report a gain under the recourse (see supra notes 40-42) or nonrecourse (see supra note 39) debt rules. Treas. Reg. § 1.1001-2(c) ex. (5) (1980).

FN113. See supra note 3.

FN114. If the debt is recourse, see supra notes 40-42 and accompanying text. If the debt is nonrecourse, see supra notes 38 and 39 and accompanying text.

FN115. See supra notes 18-25 and 36-47 and accompanying text.

FN116. Id.

FN117. See supra notes 115 and 116 and accompanying text.

FN118. For a discussion of tax simplification to alleviate complexity, see Peel, Tax Simplification: A Critique of the President's Proposals, 27 S. TEX. L.J. 27, 28 (1985).

FN119. See supra note 3.

FN120. For example, if a taxpayer who is not in bankruptcy transfers property to a creditor to satisfy debt, has gain of $100 on the transfer, and is insolvent to the extent of $60, then the taxpayer will exclude $60 of the gain from gross income under I.R.C. § 108(a) (1986). The remainder of the gain ($40) will be subject to the normal tax rules for gain. See supra note 47 and accompanying text.

FN121. I.R.C. § 108(h)(2) (Proposed Code 1986).

FN122. See supra note 45 and accompanying text.

FN123. I.R.C. § 108(h)(4) (Proposed Code 1986).

FN124. See supra notes 39 and 40 and accompanying text.

FN125. Id.

FN126. I.R.C. §§ 108(a)(1)(B) and (3) (1986), unless the Riches' debt is qualified farm indebtedness. I.R.C. § 108(g) (1986).

FN127. See supra note 45 and accompanying text.

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FN128. See supra note 6.

FN129. Note that even if a taxpayer transferred only $1 to the creditor to satisfy a $1,000,000 debt and the taxpayer was insolvent before and after the transaction, then the taxpayer would have no CODI or gain.

FN130. See supra note 16.

FN131. The IRS would collect few federal income taxes from bankrupt or insolvent taxpayers.

FN132. I.R.C. §§ 167(a) and 168(a) (1986). Depreciation lowers a taxpayer's basis in the depreciable property by the amount of depreciation allowed but not less than the amount allowable. I.R.C. § 1016(a)(2) (1986).

FN133. See supra pp. 26-27 (proposed subsection 108(h)).

FN134. I.R.C. §§ 162(a) and 212 (1986).

FN135. I.R.C. § 108(a) (1986).

FN136. I.R.C. § 108(d)(6) (1986).

FN137. The United States Securities and Exchange Commission has promulgated rules which permit limited partnership interests (securities) to be sold to an unlimited number of accredited investors (investors with a net worth in excess of $1,000,000 or with net income of $200,000) and avoid most of the public registration provisions. 17 C.F.R. § 230.501(a) and (b) (1988) under the Securities Act of 1933, 15 U.S.C.A. §§ 77a-77aa (West Supp. 1981).

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American Bankruptcy Law Journal

Summer, 1992

*323 ESSENTIALS OF BANKRUPTCY TAX LAW

Paul B. Geilich [FNa1]

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Bankruptcy lawyers' decisions and advice can profoundly affect their clients' tax liability. Unfortunately, these tax consequences are often unpremeditated. Perhaps because bankruptcy practice requires a hard-earned familiarity with its own complicated statutes and procedures, bankruptcy professionals tend to rely on others for tax advice rather than tackle the intricacies of the Internal Revenue Code themselves. Nevertheless, it is essential for bankruptcy attorneys and judges to establish a sound foundation in insolvency and bankruptcy tax law. Every attorney practicing in or around bankruptcy cases, whether representing debtors, creditors or trustees, individuals, corporations or partnerships, must understand certain tax rules without reference to manuals or experts, in order to practice competently in the field. Bankruptcy judges must likewise comprehend the tax consequences of various actions by debtors if they are to understand the method and motives behind much of the daily fare presented in their courts. The following is an analysis of the most commonly encountered bankruptcy tax issues, with an emphasis on current developments and emerging trends in the case law.

Duty to File Returns and Pay Taxes

Upon the commencement of a chapter 7 or chapter 11 case, an individual debtor's assets are deemed to be transferred to the estate. [FN1] This transfer of assets, as well as the revesting of assets in the debtor upon the closing of the case or confirmation of the plan, are not "dispositions" and, therefore, do not trigger tax liabitity. [FN2]

The estate of an individual chapter 7 or 11 debtor is a separate taxable entity, which must file tax returns and pay taxes. [FN3] The trustee of an individual's chapter 7 or 11 estate must file a federal income tax return if the estate's gross income for the taxable year is higher than the personal exemption amount plus ***324** the basic standard deduction. [FN4]

In contrast to chapter 7 and 11 cases, no separate taxable entity is created by an individual's filing of a chapter 13 case. [FN5] The distinction results from the fact that in chapter 13, unlike chapters 7 and 11, the estate includes property and income received by the debtor after commencement of the case. [FN6] Because no taxable entity is created, a chapter 13 trustee is not responsible for filing federal income tax returns.

The filing of a chapter 7 or 11 case by a corporation likewise does not create a new taxable entity. [FN7] However, a chapter 7 or 11 trustee of a corporate debtor's estate is expressly charged with the duty of filing tax returns on behalf of the corporation. [FN8] This is true whether or not the debtor's property or business continues in operation. [FN9]

Nor does the filing of a bankruptcy case by a partnership create a new taxable entity. [FN10] The provisions of Internal Revenue Code §§ 1398 and 1399, dealing with the treatment of taxable entities in individual and corporate bankruptcy cases, are expressly inapplicable at the partnership level. [FN11] A partnership interest owned by an individual debtor is treated in the same manner as any other interest owned by the debtor. [FN12]

Because the Bankruptcy Tax Act of 1980 [FN13] was enacted prior to the creation of chapter 12 in 1986,

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[FN14] uncertainty has always existed as to the tax treatment of a chapter 12 estate. Internal Revenue Code § 1399 states that no separate taxable entity results from the commencement of a bankruptcy case except a case to which § 1398 applies, and § 1398 applies by its terms only ***325** to chapter 7 and chapter 11 cases. Furthermore, like chapter 13, chapter 12 provides that property of the estate includes property and income received by the debtor after the commencement of a case. [FN15] In contrast, however, a chapter 12 trustee is required to file state and local tax returns for the estate in precisely the same manner required under chapter 11. [FN16] This inconsistency has caused much debate, since it seems unfair to deny the family farmer, typically more of a businessman than a consumer, the favorable tax planning techniques available to an individual debtor in a chapter 7 or a chapter 11 case. Nevertheless, the plain meaning of §§ 1398 and 1399 seems to require the conclusion that a chapter 12 estate is not a separate taxable entity, and the Internal Revenue Service has expressly taken this position in a private letter ruling. [FN17]

Whenever a trustee must file a tax return, he or she is also required to pay the tax as determined by the return. [FN18] This duty exists without need for assessment, notice or demand from the Internal Revenue Service. [FN19] A trustee who fails to prepare tax returns and pay taxes may be personally "surcharged" for penalties and interest accruing as a result. [FN20]

In Holywell Corporation v. Smith [FN21] the United States Supreme Court recently ruled that the trustee of a liquidating trust formed under a chapter 11 plan of reorganization had a duty to file federal income tax returns and pay taxes. The court held that the trustee was an "assignee" of the bankruptcy estate, and was, therefore, required to file returns and pay taxes under Internal Revenue Code § 6012(b)(3). The trustee argued that the liquidating trust was a "grantor trust" and the debtor a "grantor" as defined in Treasury regulations, in which case the debtor would be obliged to pay taxes on any income of the trust applied in discharge of the debtor's obligations. [FN22] But the Court ruled that in this case the property of the estate never revested in the debtor upon confirmation. Rather, it was assigned directly to the liquidating trust, so the debtor could not have been a grantor. [FN23]

***326** Priority of Tax Claims

Taxes incurred by the estate subsequent to commencement of the case are first priority administrative expenses. [FN24] Most other tax claims receive seventh priority treatment under Bankruptcy Code § 507(a)(7). [FN25] These include:

(a) Pre-petition income and gross receipt taxes to the extent the tax return was due either after the petition date or three years before the petition was filed, including any requested extensions.

(b) Income and gross receipt taxes assessed any time within 240 days before the commencement of the case, plus any extensions, or assessed after the filing of the case under applicable law or by agreement.

(c) Real and personal property taxes assessed pre-petition and payable without penalty within one year prior to the filing of the case.

(d) Taxes required to be collected or withheld by the debtor, e.g., employee withholding taxes, regardless of age.

(e) An employer's share of employment taxes on wages and salaries, whether or not the wages were actually paid, if the return for these was last due within three years before the petition was filed or after the petition was filed.

(f) Federal, state and local excise taxes, for which a return is due in the three years prior to the filing of the case, or after the case is filed.

(g) Customs duties on imports, subject to certain age restrictions.

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(h) Penalties related to any of the above tax claims, but only if in compensation for actual pecuniary loss, as opposed to fines. [FN26]

An interesting twist is added by Bankruptcy Code § 724(b)(2). [FN27] Under this section secured tax claims are subordinated to unsecured claims given priority under § 507(a)(1)-(6). [FN28] This has the curious effect of "securing" priority unsecured claims up to the amount of the tax lien in chapter 7 cases. If priority unsecured claims equal or exceed the amount of the tax lien, the tax is completely unsecured, which allows junior lienholders to be paid to the exclusion of an apparently senior tax lien. [FN29]

***327 Discharge** of Tax **Indebtedness**

The tax liability of a corporate debtor in a chapter 7 case or a liquidating chapter 11 case is never discharged. [FN30] However, an individual debtor may receive a discharge from any tax claims not granted priority under Bankruptcy Code § 507(a)(2) ("gap" claims in involuntary cases) or § 507(a)(7). [FN31] Therefore, subject to the exceptions set forth below, federal income tax claims against individuals are discharged if they were incurred with regard to returns for which the due date, including extensions, is more than three years before the bankruptcy petition is filed, and for which no assessment has been made within the 240 days prior to the filing of the case. [FN32]

It is quite possible for taxes more than three years old to be non-dischargeable because they have been assessed within 240 days of the bankruptcy case. For example, a tax otherwise dischargeable under the three-year rule could be unassessed pending an audit, or due to litigation in the U.S. Tax Court, during which time the debtor is not required to pay the disputed tax. If the audit results in liability, or the debtor loses the Tax Court case, the Internal Revenue Service will assess the tax, and then has 240 days to perfect its liens and collect the tax before the claim becomes dischargeable in bankruptcy. [FN33] If the taxpayer makes an offer in compromise within the 240-day period prior to filing the bankruptcy case, this 240 day period is tolled during the time that the offer is pending. Once the offer terminates, the Service is given an additional 30 days to conduct its lien perfection and collection activities before the tax becomes dischargeable. [FN34]

Exceptions to the discharge apply if no return was filed, [FN35] a fraudulent return was filed, the debtor willfully attempted to evade or defeat the tax, [FN36] or if a late return was filed within two years prior to the filing of the bankruptcy petition. [FN37]

Balances remaining due on taxes after successful completion of a confirmed chapter 13 plan are discharged. [FN38]

Determination of Tax Liability of the Estate

Generally, the bankruptcy estate is entitled to the same deductions the ***328** debtor had on assets transferred to the estate. [FN39] The estate also succeeds to most of the debtor's tax attributes for the last full taxable year, as follows: (a) net operating loss carryovers, (b) charitable contribution carryovers, (c) recovery of tax benefit items, (d) tax credit carryovers, (e) capital loss carryovers, and (f) **basis,** holding period and character of pre-petition assets. [FN40]

The cancellation of debt received by an individual debtor upon discharge in a bankruptcy case does not result in taxable income. [FN41] However, the estate's tax attributes will be reduced by the amount of the debtor's discharge, [FN42] in the following order:

(a) Net operating losses [FN43]

(b) General business credit

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(c) Capital loss carryovers

(d) **Basis** in assets

(e) Foreign tax credit carryovers [FN44]

Section 505 of the Bankruptcy Code [FN45] provides a trustee or debtor-in-possession an opportunity to seek determination of any tax liability from the bankruptcy court. [FN46] This determination may be made even if the tax has previously been assessed, although a previously contested and adjudicated tax may not be relitigated before the bankruptcy court. [FN47]

A trustee may also request a taxing authority to determine any unpaid tax liability of the estate by submitting a tax return and a request for such determination. [FN48] If the tax shown on the return is paid by the trustee, and the taxpaying authority does not notify the trustee within sixty days after a request for ***329** determination that the return has been selected for examination, the trustee, the debtor and any successor to the debtor are discharged of any further tax liability. [FN49]

Two courts have recently decided that, although Bankruptcy Code § 505(b)(1)(A) discharges the trustee and the debtor from personal liability for estate taxes after expiration of the statutory 60-day period, the estate does not receive the same protection. The courts reasoned that, because the bankruptcy estate is not a "trustee, debtor or successor to the debtor," it is not discharged under § 505(b)(1)(A) and must pay the tax claims so long as the estate remains open. [FN50]

Debtor's Short Tax Year Election

Individual debtors in chapter 7 or 11 cases may elect to treat the year in which the bankruptcy petition is filed as two taxable years, the first of which ends on the day before the petition is filed ("the short year"), and the second of which begins on the day the petition is filed. [FN51] The election is irrevocable, and may be made only if the debtor owns non-exempt assets. [FN52] The deadline for making the election, and for filing the tax return for the short year, is the fifteenth day of the fourth full month following the end of the short year. [FN53] If a chapter 7 or 11 case is dismissed, a previously- made short year election is extinguished and all taxes incurred by the estate pass back to the debtor. [FN54]

If the short year election is made, the debtor's tax liability for the short year becomes an allowable pre-petition claim against the estate. Therefore, assets of the estate must be used to pay any tax liability for that period. If the estate cannot pay the taxes for lack of available funds, the debtor remains liable for any non-dischargeable taxes not paid by the estate. [FN55]

A myriad of bewildering hypothetical situations have been used over the years to confuse bankruptcy lawyers about the applicability of the short year election to a given set of facts. Complex financial statements and transactions, of course, can always make the determination of tax liability difficult. The deciphering of these transactions for tax return purposes is perhaps best left to a tax expert. But once the expert has determined taxable income or loss for the proposed two taxable years, the bankruptcy lawyer's work is reduced to ***330** a relatively simple evaluation of the proposed tax return for the short year. If the short year return would result in a tax liability, the election should probably be made since this would become a liability of the estate. If, however, the short year return would result in a net loss, i.e., a tax attribute, by foregoing the election the debtor should be able to use the loss to offset post-petition income. [FN56]

Directed Application of Tax Payments

Responsible officers or employees of corporations, or partners or employees of partnerships, who willingly fail to collect and pay employee withholding taxes are personally liable for a penalty equal to the total amount of the

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tax evaded. [FN57] To avoid this 100% penalty, officers or partners of financially troubled business organizations often cause the entity to make payments to the Internal Revenue Service with directions to apply the payments to these "trust fund" taxes. [FN58] So long as the payment is entirely voluntary, the taxpayer has the right so to direct the application of the payment to whatever type of liability it chooses. [FN59]

Involuntary payments by the taxpayer, however, may be applied by the Service as it sees fit. [FN60] A payment is generally deemed involuntary if it is received as a result of distraint or levy, or from a legal proceeding where the government files a claim or seeks to collect delinquent taxes. [FN61] Payments made by the estate in chapter 7 bankruptcy cases are almost always held to be involuntary. [FN62]

Until recently, the Service took the position that payments received during chapter 11 cases were likewise involuntary. [FN63] This issue divided the circuits until the case of United States v. Energy Resources Company, [FN64] in which the United States Supreme Court ruled that a bankruptcy court may order the Internal Revenue Service to apply chapter 11 payments to trust fund taxes as directed under a confirmed plan of reorganization "if necessary for the success *331 of the plan," whether or not the payments are considered involuntary. [FN65] The Court pointed out that the Service could still collect the 100% penalty from responsible officers and employees under Internal Revenue Code § 6672. [FN66]

Abandonment of Property by the Trustee

A problem frequently arises when a bankruptcy estate holds property with a low tax **basis** which is subject to debt in excess of its fair market value. Although there is clearly no value in the property for creditors, if the trustee allows the automatic stay to lift and the secured creditor to foreclose, the transfer of title will trigger taxable gain to the estate if the **basis** in the property is less than the foreclosure price. [FN67]

The abrupt rise in real property foreclosures in the latter half of the 1980's spawned creative attempts by debtors to avoid recapture of accelerated depreciation by filing a bankruptcy petition just prior to foreclosure, in order to trap the recapture liability in the estate. Trustees reacted by abandoning the property back to the debtor [FN68] before the stay could be lifted and the property foreclosed while in the estate, which rendered the debtor liable for any tax consequences resulting from a subsequent disposition of the property, including foreclosure. [FN69]

The debtor bears a heavy burden as a result of this strategy by the trustee. Although the debtor is fully liable for the taxes, the debtor's non-exempt assets and tax attributes are owned by the estate and are not available to pay the tax liability. In addition, the adjusted **basis** in the property may have been further reduced while in the estate by the reduction in tax attributes resulting from the debtor's discharge.

One district court recently decided that Internal Revenue Code § 1398(f)(2), [FN70] relied upon by trustees to shield the abandonment from the usual taxable event rules, does not apply to § 554 abandonments under the *332 Bankruptcy Code. [FN71] Under this case the abandonment by the trustee generates a tax liability which the estate must bear. The court reasoned that this is not an unfair burden because the estate succeeds to the tax attributes of the debtor upon commencement of the case, which it can use to offset all or part of the tax liability. [FN72]

Conclusion

Knowledge of these tax rules will not convert bankruptcy lawyers into tax lawyers, but it will provide a sound **basis** for advising financially troubled clients of the major tax consequences of their actions, and will help identify the dividing line between expert insolvency advice and inexpert tax advice. By no means does this synopsis provide an exhaustive review of all bankruptcy tax issues, but a thorough familiarity with these key concepts could at least save some potential embarrassment, and perhaps much more.

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FN1. 11 U.S.C.A. § 541 (West 1979 & Supp.1992).

FN2. 26 U.S.C.A. § 1398(f)(1) (West 1988). Title 26 of the United States Code is the Internal Revenue Code. The Bankruptcy Code is contained in title 11.

FN3. 26 U.S.C.A. § 1399 (West 1988). As a fiduciary of the new entity, a chapter 7 or 11 trustee must obtain a new taxpayer identification number and file Form 1041-U.S. Fiduciary Income Tax Return.

FN4. 26 U.S.C.A. §§ 6012(a)(9) & (b)(4) (West 1989). Currently the sum of the personal exemption amount plus the basic standard deduction (for bankruptcy estates, deemed to be equal to the deduction for married individuals filing separately) is $5,300.

FN5. 26 U.S.C.A. § 1399 (West 1988). This should be distingished from the separate treatment of a chapter 13 estate for bankruptcy purposes.

FN6. 11 U.S.C.A. § 1306(a) (West 1979 & Supp.1992).

FN7. 26 U.S.C.A. § 1399 (West 1988).

FN8. 26 U.S.C.A. § 6012(b)(3) (West 1989). Because no separate taxable entity is created, a chapter 7 or 11 trustee's corporate tax return is not a fiduciary return, but is filed on behalf of the corporation on the same forms used if no bankruptcy case were involved.

FN9. Trustees of operating estates must withhold income and social security taxes from payment of wages or wage claims of employees of the estate. 26 U.S.C.A. § 3401(d) (West 1989); 26 U.S.C.A. § 3402(a) (West 1989 & Supp.1992). Under currently pending S. 1985, 102d Cong., 2d Sess. § 404(a) (1991) (sponsored by Senators Hefflin and Grassley), a trustee would be required to maintain a separate bank account for post-petition withholding and social security taxes, deposit all such taxes therein, and remit the taxes to the appropriate governmental unit in a timely manner.

FN10. 26 U.S.C.A. § 1399 (West 1988).

FN11. 26 U.S.C.A. § 1398(b)(2) (West 1988). Consequently, partnership debtors in possession and trustees report on the usual partnership information return forms.

FN12. Id.

FN13. Pub. L. No. 589, 94 Stat. 3389 (1980), reprinted in 1980 U.S.C.C.A.N. (94 Stat.) 3389.

FN14. Chapter 12 was promulgated in the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 554, reprinted in 1986 U.S.C.C.A.N. (100 Stat.) 3114.

FN15. 11 U.S.C.A. § 1207(a) (West Supp.1992).

FN16. 11 U.S.C.A. § 1231 (West Supp.1992). This "special tax provisions" section of chapter 12 is identical to § 1146 of chapter 11, 11 U.S.C.A. § 1146 (West 1978 & Supp.1992). Neither section addresses federal tax treatment.

FN17. Priv. Ltr. Rul. 89-280-12 (July 14, 1989).

FN18. 26 U.S.C.A. § 1398(c)(1) (West 1988); 26 U.S.C.A. § 6151(a) (West 1989).

FN19. 26 U.S.C.A. § 6151(a) (West 1989).

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FN20. Lopez-Stubbe v. Rodriguez-Estrada (In re San Juan Hotel Corp.), 847 F.2d 931, 946 (1st Cir.1988).

FN21. 112 S.Ct. 1021 (1992).

FN22. Treas. Reg. § 1.677(a)-1(d) (1991).

FN23. 112 S.Ct. at 1027. The Court implied that the trustee's argument would have been successful if the plan of reorganization had allowed the property of the estate to revest in the debtor prior to assignment to the liquidating trust, the normal state of affairs under Bankruptcy Code § 1141(b). Debtor's counsel can avoid this possibility by drafting the plan and confirmation order to effect a "deemed" assignment directly from the estate to the liquidating trust.

FN24. 11 U.S.C.A. § 507(a)(1) (West 1979); 11 U.S.C.A. § 503(b)(1)(B) (West 1979 & Supp.1992). A trustee is generally held personally liable for penalties and interest on unpaid administrative taxes. Lopez-Stubbe v. Rodriguez-Estrada (In re San Juan Hotel Corp.), 847 F.2d 931, 946 (1st Cir.1988). MICHAEL L. COOK, ROBERT D'AGOSTINO & KENNETH N. KLEE, 4 COLLIER ON BANKRUPTCY ¶ 704.04 at 704-12 (Lawrence P. King ed.) (15th ed. 1992). Therefore if a taxing authority fails to file a valid administrative claim, the trustee should file the claim as authorized under Bankruptcy Code § 501(c), file a return and pay the tax.

FN25. 11 U.S.C.A. § 507(a)(7) (West Supp.1992).

FN26. Id.

FN27. 11 U.S.C.A. § 724(b)(2) (West Supp.1992).

FN28. 11 U.S.C.A. § 507(a)(1)-(6) (West 1979 & Supp.1992).

FN29. COLLIER, supra note 24, at ¶ 724.03 at 724-8. Tax claims which are oversecured by federal tax liens continue to accrue interest after the filing of a bankruptcy case, up to the amount of the lien. United States v. Ron Pair Enterprises, Inc., 489 U.S. 235 (1989).

FN30. 11 U.S.C.A. § 727(a)(1) (West 1979); 11 U.S.C.A. § 1141(d)(3) (West 1979).

FN31. 11 U.S.C.A. § 507(a)(7) (West Supp.1992).

FN32. The controlling date for this three-year rule is the due date of the return, plus extensions, not the date the tax was paid or the return was filed. 11 U.S.C.A. § 507(a)(7)(A)(i) (West 1979 & Supp.1992).

FN33. 11 U.S.C.A. § 507(a)(7)(A)(ii) (West 1979 & Supp.1992).

FN34. Id. Debtor's counsel should be careful in timing the offer-in-compromise to avoid extension of the 240-day period if bankruptcy is under consideration.

FN35. 11 U.S.C.A. § 523(a)(1)(B)(i) (West 1979).

FN36. 11 U.S.C.A. § 523(a)(1)(C) (West 1979). An exception to this exception applies in chapter 13 cases if the debtor completes payments under the plan of reorganization. 11 U.S.C.A. § 523(a) (West 1979 & Supp.1992); 11 U.S.C.A. § 1328(a) (West 1979 & Supp.1992).

FN37. 11 U.S.C.A. § 523(a)(1)(B)(ii) (West 1979).

FN38. 11 U.S.C.A. § 1328(a) (West 1979).

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FN39. 26 U.S.C.A. §§ 1398(e)(3) & (f)(1) (West 1988).

FN40. 26 U.S.C.A. § 1398(g) (West 1988). Under this sub-section the transfer of tax attributes to the estate is determined as of the first day of the debtor's tax year in which the bankruptcy case is filed, i.e., January 1 for calendar-year debtor/taxpayers. Tax attributes accruing after that date remain property of the debtor.

FN41. **26** U.S.C.A. **§108(a)(1)(A)** (West 1988 & Supp.1992).

FN42. The debtor's discharge reduces the estate's tax attributes: in a chapter 7 or 11 case the estate, not the individual, is treated as the taxpayer for purposes of reducing attributes under § 108(b)(1) and (2). **26** U.S.C.A. § **108(d)(8)** (West 1988 & Supp.1992). In this manner the government avoids the loss in tax revenue which would result from separating the favorable tax treatment of the debtor's discharge from the estate's tax attributes.

FN43. The trustee may avoid reduction of net operating losses by electing instead to reduce **basis** in depreciable property. **26** U.S.C.A. § **108(b)(5)** (West 1988 & Supp.1992).

FN44. **26** U.S.C.A. § **108** (b)(1) & (2) (West 1988 & Supp.1992). The reduction is dollar-for-dollar, except on general business and foreign tax credit carryovers, which are reduced 33 1/3 cents for each dollar of cancellation-of-debt income excluded from gross income. **26** U.S.C.A. § **108(b)(3)** (West 1988 & Supp.1992).

FN45. 11 U.S.C.A. § 505 (West 1979 & Supp.1992).

FN46. The policy behind § 505 is to allow a prompt resolution of the debtor's tax liability and to avoid the dissipation of the estate's assets which could result if the debtor failed to challenge a tax assessment prior to commencement of the case City Vending v. Oklahoma Tax Comm'r, 898 F.2d 122, 124 (10th Cir.1990).

FN47. 11 U.S.C.A. § 505(a) (West 1979). For example, the trustee may litigate a previously assessed but unlitigated ad valorem property tax claim if the claim was based on an alleged over-valuation of the property.

FN48. 11 U.S.C.A. § 505(b) (West 1979).

FN49. 11 U.S.C.A. § 505(b)(1)(A) (West 1979). An identical discharge results if the government, having undertaken an examination of the return, fails to complete the examination and notify the trustee of any tax due within 180 days of the trustee's request for a determination. 11 U.S.C.A. § 505(b)(1)(B) (West 1979).

FN50. In re Fondiller, 125 B.R. 805 (N.D. Cal. 1991); In re Rode, 119 B.R. 697 (Bankr. E.D. Mo. 1990).

FN51. 26 U.S.C.A. § 1398(d)(2)(A) (West 1988). The debtor's spouse may join in this election if a joint return is filed for the short year. 26 U.S.C.A. § 1398(d)(2)(B) (West 1988).

FN52. 26 U.S.C.A. §§ 1398(d)(2)(C) & (E) (West 1988).

FN53. 26 U.S.C.A. § 1398(d)(2)(E) (West 1988).

FN54. 26 U.S.C.A. § 1398(b)(1) (West 1988). In this situation the tax attributes previously transferred to the estate will also revest in the debtor.

FN55. 11 U.S.C.A. § 523(a)(1) (West 1979 & Supp.1992).

FN56. This offset is subject to rules governing use of certain losses.

FN57. 26 U.S.C.A. § 6671(b) (West 1989); 26 U.S.C.A. § 6672(a) (West 1989 & Supp.1992).

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FN58. Such payments made just prior to commencement of a bankruptcy case are not preferential transfers, because amounts required to be withheld for payment of trust fund taxes are not property of the debtor. Begier v. IRS, 496 U.S. 53 (1990). Even post-petition transfers of this nature are not recoverable by the trustee in an adversary proceeding seeking monetary recovery, because of the sovereign immunity of the United States, pursuant to the recent decision in United States v. Nordic Village, Inc., 112 S.Ct. 1011 (1992).

FN59. Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir.1983). If both the debtor and the IRS fail to allocate pre-petition voluntary payments, the bankruptcy court may allocate the payments under 11 U.S.C.A. § 505 (West 1979). In re Vermont Fiberglass, Inc., 76 B.R. 358, 368 (Bankr. D.Vt. 1987), rev'd on other grounds, 88 B.R. 41 (D.Vt. 1988).

FN60. U.S. v. De Beradinis, 395 F.Supp.944, 952 (D.Conn. 1975), aff'd 538 F.2d 315 (2d Cir.1976).

FN61. Amos v. Commissioner, 47 T.C. 65 (1966).

FN62. In re Looking Glass, Ltd., 113 B.R. 463, 466-67 (Bankr. N.D. Ill. 1990).

FN63. The Internal Revenue Manual, used to guide revenue agent procedures, states that any payments received from bankruptcy estates should be applied per court order, or if no order is entered, should be credited in a manner "as to give maximum benefit to the United States insofar as future collections are probable" IRM § 57(13)4.3(1).

FN64. 495 U.S. 545 (1990).

FN65. Id. at 548.

FN66. This does not solve the problem presented when the corporation has just enough funds available to pay the trust fund taxes, but no more. In this situation an alternate source of recovery for the IRS, i.e., the responsible officer, could be eliminated, since stated IRS policy is to refrain from collecting the 100% penalty if the underlying tax is paid. I.R.S. Policy Statement P-5-60.

FN67. For example: An estate holds property with an adjusted **basis** of $100 which has a fair market value of $200 and is subject to secured recourse debt of $300. If the trustee allows the stay to lift and the property is foreclosed at $200, a taxable gain of $100 accrues to the estate.

FN68. A trustee is authorized to abandon property by 11 U.S.C.A. § 554 (West 1979 & Supp.1992).

FN69. **26** U.S.C.A. §§ **108(b)(2)** & (b)(5) (West 1988 & Supp.1992). A possible planning device allowing the debtor to avoid this problem is to identify property likely to be abandoned and dispose of it in a non-fraudulent manner prior to filing the bankruptcy petition. Once the bankruptcy case is filed and the short tax year is elected, any liability arising from the disposition is a liability of the estate, although excess liability after the estate's funds are exhausted, is a non-dischargeable liability of the debtor.

FN70. 26 U.S.C.A. § 1398(f)(2) (West 1988).

FN71. In re A.J. Lane & Co., 133 B.R. 264 (Bankr. D.Mass. 1991). The court pointed out that § 1398(f)(2) is applicable by its terms only to deemed transfers from the estate to the debtor upon the closing of the case, not to an abandonment of specific property during the case. Contra, Samore v. Olson (In re Olson), 930 F.2d 6, 8 (8th Cir.1991).

FN72. In re A.J. Lane & Co., 133 B.R. 264, 274 (Bankr. D.Mass. 1991).

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THE TAX CONSEQUENCES OF STOCK-FOR-DEBT EXCHANGES

University of Pittsburgh School of Law

Spring, 1992

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I. INTRODUCTION

Corporate debt restructurings and bankruptcies are reaching a level in the 1990s not approached since the Great Depression. [FN1] Due to the economic slowdown and the aftermath of the leveraged buyouts of the 1980s, many corporations find it necessary to restructure their debt. Often these companies cancel their outstanding debt in exchange for either a new debt interest or an equity interest in the corporation. (This latter exchange is referred to as a "stock-for-debt exchange.") The stock-for-debt exchange is an exception to the general rule that corporations recognize income when they cancel outstanding debt at a discount. This "stock-for-debt exception," however, has been significantly limited by both Congress and the Internal Revenue Service in 1990, at a time when it has been needed most. The author will discuss cancellation of indebtedness income ("COD income") and the exclusion of COD by insolvent and bankrupt companies under Internal Revenue Code s 108 [FN2] and will then analyze the creation and justification of the stock-for-debt exception. Lastly, the author will focus on the limitations placed upon the exception by Congress and the Internal Revenue Service (the "Service").

II. CANCELLATION OF INDEBTEDNESS INCOME

Cancellation of a debt for less than the amount borrowed produces income for the debtor. Thus, if a corporation borrows $1000 and later discharges the debt for $750, the debtor will have $250 of cancellation of indebtedness income. This result is justified by two separate theories. [FN3]

The first approach, the balance sheet test, looks at the debtor's position in balance sheet terms. If the debtor borrows $1000, its balance sheet would reflect an asset (cash) of $1000 and a corresponding liability (the loan obligation) of $1000. The debtor's net worth is zero. When the corporation later discharges the debt for $750, the corporation's assets are reduced by $750 ($1000 - $750 = $250). The liability, however, is eliminated ($1000 - $1000 = $0). At this point the debtor has an increase in net worth of $250. This increase in net worth is income.

The second approach focuses on the fact that at the time the corporation borrows money the corporation receives cash, but is not required to include that cash in income. Borrowing money is not a realization event. Until a realization event occurs, the taxpayer does not include the borrowed money in

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income. When the debt is discharged at a discount, however, the tax deferral on the cash ends because the cash proceeds of the initial loan are no longer burdened by the repayment obligation. The **discharge** of **indebtedness** is a realization event triggering income to the taxpayer. Courts following this approach require the debt to be issued for cash or property. [FN4] Since this approach to COD income seeks to tax the original cash received that is not later repaid, there must be an original receipt of cash or property.

A. Inclusion of COD Income

1. The Common Law Approach

The principle that gross income includes cancellation of indebtedness has been long established. [FN5] Although Treasury regulations adopted this principle as early as 1918, [FN6] the concept of COD income derived from the well-known Kirby Lumber [FN7] decision of the Supreme Court in 1931.

In Kirby Lumber, the taxpayer issued its own bonds receiving $12,126,800. The bonds were not issued for cash, but in exchange for Kirby Lumber's preferred stock, on which there were dividend arrearages. [FN8] The same bonds were repurchased later in the year at a discount of $137,521.30. The Court held the discount was taxable income in the year of the repurchase, stating that: "[a]s a result of its dealings, [a taxpayer] made available $137,521.30 assets previously offset by the obligation of bonds now extinct. [The taxpayer] has realized within the year an accession to income, if we take words in their popular meaning...." [FN9]

2. The Statutory Approach

The Kirby Lumber "freeing of assets" concept is codified in section 61(a)(12), which provides that "gross income means all income from whatever source derived, including income from **discharge** of **indebtedness.**" The regulations state that a taxpayer may realize income "by the payment or purchase of his obligations at less than their face value." [FN10]

B. The Exclusion of COD Income

1. Common Law Exceptions

Numerous common law exceptions developed excluding COD from income. COD income was excluded from gross income where the taxpayer was insolvent before and after the debt discharge. [FN11] The courts reasoned that the discharge of debts cannot "free" assets of a debtor that remained insolvent even after the discharge, since the debtor still had a negative net worth. If the discharge made the taxpayer solvent, COD income was included to the extent of such solvency. [FN12]

The insolvency exception is justified today by reference to bankruptcy policy. Although cancellation of a debt improves the balance sheet, the debtor does not have any more cash after the discharge. The debtor needs to be shielded from tax on economic income that it is unable to currently pay.

2. Statutory Exclusion of COD Income

Congress determined that relief from COD income was necessary in bankruptcy proceedings. Bankruptcy laws would be frustrated if relief from debt created

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income tax liabilities jeopardizing the debtor's recovery. [FN13] To protect debtors, Congress enacted the Bankruptcy Tax Act of 1980 codifying the judicial insolvency exception. [FN14] The Senate Report stated:

> The rules of the bill concerning income tax treatment of debt discharge in bankruptcy are intended to accommodate bankruptcy policy and tax policy. To preserve the debtor's 'fresh start' after bankruptcy, the bill provides that no income is recognized by reason of debt discharge in bankruptcy, so that a debtor coming out of bankruptcy (or an insolvent debtor outside bankruptcy) is not burdened with an immediate tax liability. [FN15]

Thus, **26** U.S.C. s **108(a)(1)** provides that COD income is excluded from gross income if the discharge occurs in a title 11 case or when the taxpayer is insolvent. [FN16] Section 108(a)(3) limits the amount of COD income excluded to the amount of the debtor's insolvency. The term "title 11 case" means a case under title 11 of the Bankruptcy Code, but only if the taxpayer is under the jurisdiction of the Bankruptcy Court and the discharge is granted by the court or is pursuant to a plan approved by the court. [FN17] "Insolvent" is defined as "the excess of liabilities over the fair market value of assets" [FN18] and is determined on the **basis** of the taxpayer's assets and liabilities immediately before the discharge. [FN19]

Taxpayers under title 11 have a significant advantage over other insolvent taxpayers because title 11 taxpayers need not prove their net worth. Outside of bankruptcy, a taxpayer must demonstrate its insolvency by valuation of assets. Some authorities suggest that contingent liabilities should be considered in measuring insolvency. [FN20] The courts have held that insolvency valuation requires a computation of any goodwill or going concern values inherent in the taxpayer's business. [FN21] The fair market value of such assets may be difficult to determine in a troubled company restructuring.

> Example 1: D, a financially distressed corporation not under title 11 has assets valued at $75x and liabilities of $100x. An out of court restructuring of D's debt results in $50x of COD income. Under current law, D may only exclude $25x of COD under section 108(a), the amount of D's insolvency prior to the discharge. D will recognize $25x of COD income. Had D been a title 11 debtor, D could exclude the entire $50x, without regard to D's insolvency.

In cases of insolvency, the debt and equity structure of the debtor may be scrutinized. If the debt of a thinly capitalized corporation is recharacterized as equity, the corporate debtor may become solvent. The result of such a recharacterization may be recognition of COD income. [FN22]

C. Attribute Reduction

1. Under Section 108(b)

Although section 108(a) excludes COD income from gross income, the taxpayer must pay a price for such exclusion. Although bankruptcy may be an inappropriate occasion to tax COD income, the debtor should not be able to enjoy both tax-free relief from debts and carryover of the losses created by the borrowed funds. [FN23] The debtor is entitled to a "fresh start, not a head start." [FN24] Section 108(b) therefore provides that the debtor's tax attributes will be reduced when COD income is excluded under section 108(a).

Section 108 is a deferral provision. The COD income excluded reduces certain

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specified tax attributes of the debtor, eliminating tax savings in the future. [FN25] The attributes are reduced in the following order:

(1) Net operating loss (NOL) for the taxable year of the discharge and any net operating loss carryover to such taxable year.

(2) Any carryover to or from the taxable year of a discharge of an amount for purposes of determining the amount allowable as a credit under section 38 (relating to general business credit).

(3) Net capital loss for the taxable year of the discharge, and any capital loss carryover to such taxable year under section 1212.

(4) The **basis** of the property of the taxpayer as provided in section 1017.

(5) Any carryover to or from the taxable year of the discharge for purposes of determining the amount of the foreign tax credit. [FN26]

Except for the general business credit and the foreign tax credit, all of the tax attributes are reduced dollar for dollar. The credits are reduced 33 1/3 cents for each dollar of income excluded. [FN27] If the taxpayer has insufficient tax attributes to absorb the excluded COD income, the excess is disregarded and is never considered income to the debtor. [FN28]

After reducing NOLs, business credits and capital losses, section 108(b)(2)(D) provides that the taxpayer must reduce the **basis** of all the taxpayer's depreciable and nondepreciable property to the extent of the remaining COD income. The **basis** of the depreciable and nondepreciable property is reduced under the rules of section 1017. [FN29] An important limitation on section 108(b) is section 1017(b)(2), under which the reduction of asset **bases** cannot exceed the excess of (i) the aggregate of the **basis** of the property held by the taxpayer immediately after the discharge over (ii) the aggregate of the liabilities of the taxpayer immediately after the discharge. Thus, the tax **basis** of the debtor's assets after the discharge will not be less than its undischarged liabilities. [FN30]

Example 2: B is involved in a title 11 proceeding. B's creditors agree to accept 50x cash for their 100x debt. B has 25x in NOLs, 5x in capital losses, 1x in investment tax credits and 60x **basis** in depreciable property. B has 55x of nondischarged liabilities. B's discharge of 100x debt for 50x cash would produce COD income of 50x which would be excluded from B's gross income under section 108(a). Under section 108(b), B would make the following reductions:

50x COD income
(25x) NOL eliminated
(5x) capital losses eliminated
(3x) investment tax credit is eliminated to offset 3x COD income
(5x) **basis** reduction, limited to aggregate asset **bases** less undischarged liabilities of the taxpayer after discharge (60-55 = 5)
12x (Remaining untaxed COD income. This amount escapes taxation entirely.)

2. Election to Reduce **Basis** in Depreciable Property

Under section 108(b)(5), a taxpayer may elect to reduce the **basis** of its depreciable assets in accordance with section 1017 rather than reducing its other tax attributes. If a taxpayer makes the section 108(b)(5) election, it may reduce the entire **basis** of the property (unlike **basis** reduction under section 108(b)(2)(D) where the **basis** may not be reduced below

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the remaining undischarged liabilities). If depreciable **basis** reduction is elected, no other attributes need be reduced. [FN31] The election can only be made in the year of discharge on the taxpayer's return. [FN32] Consent of the service is required to revoke the election. [FN33]

Depreciable property is defined as property subject to an allowance for depreciation, but only if a permitted **basis** reduction would reduce the depreciation otherwise allowable for the period following such reduction. [FN34] Further, the taxpayer may elect to treat certain property interests as depreciable. A partnership interest may be treated as depreciable under section 1017. [FN35] Under certain circumstances, a parent may treat stock in a subsidiary as depreciable property. [FN36] Inventory may also be treated as depreciable. [FN37] Gain upon the disposition of section 1017 property will be treated as ordinary gain under section 1017(d).

Example 3: Assume the same facts as example 2. Instead of reducing its attributes, B elects under section 108(b)(5) to reduce **basis** on depreciable property:

50x COD income
(50x) depreciable **basis** reduction (10x adjusted **basis** remains)
(0x) NOL reduction (25x remains)
(0x) capital loss reduction (5x remains)
(0x) investment credit (1x remains)
0 COD remaining

A debtor would prefer the section 108(b)(5) election if future income was anticipated. The use of the future carry forward of NOLs to offset income is generally more beneficial than future tax benefits resulting from depreciation. [FN38] Because of the time value of money, the ability to shield $25x of income in year one with an offsetting NOL is more valuable than receiving $5x of depreciation deductions for years one through ten (using the straight line depreciation method). A reduction in **basis** is only attractive if B does not intend to sell his assets for several years, deferring possible gain on the disposition indefinitely.

III. THE STOCK-FOR-DEBT EXCEPTION TO COD

Often, a debtor would like to completely avoid COD income and section 108. If **discharge** of **indebtedness** does not result in COD income, then section 108(b) would be inapplicable and the debtor would not have to reduce any attributes or **basis.** Without the reduction of NOLs under section 108(b) a debtor can use those NOLs to offset future income and reduce future taxes in the early years after reorganization. Thus, debtors frequently strive to qualify cancellation of indebtedness under the "stock-for-debt" exception. [FN39] The ability of the debtor to cancel indebtedness without attribute reduction by means of the stock-for-debt exception can be critical to the debtor's reorganization. [FN40]

A. The Creation of the Stock-For-Debt Exception

The stock-for-debt exception was judicially created in Capento Securities Corp. v. Commissioner. [FN41] In that case, Raytheon Production Corporation (Raytheon), a wholly owned subsidiary of the Raytheon Manufacturing Co., issued $500,000 in face value bonds in 1929. In 1933, Raytheon Manufacturing Co. organized a second wholly owned subsidiary, Capento Securities Corporation (Capento), for the purpose of purchasing Raytheon's $500,000 bonds from the

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bondholders. Capento purchased all of the bonds at a cost of $15,160. The bonds were Capento's only assets.
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American Bankruptcy Law Journal

Winter, 1992

*55 FEDERAL TAXATION OF CORPORATE REORGANIZATIONS

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This article analyzes the taxation of corporate reorganizations in bankruptcy including cancellation of indebtedness income under section 108 of the Internal Revenue Code, tax free reorganizations under section 368(a)(1)(G) of the Internal Revenue Code, net operating losses under section 382 of the Internal Revenue Code, and the procedure for determining the tax consequences of bankruptcy reorganization. The article focuses on the collision of the Internal Revenue Code and the Bankruptcy Code and the ambiguities that result in bankruptcy tax law. It concludes that both tax policy and bankruptcy policy would be promoted by enabling the bankruptcy courts to make binding advance determinations of the tax effects of bankruptcy reorganizations under section 1146 of the Bankruptcy Code.

INTRODUCTION: BANKRUPTCY TAX POLICY

The following bankruptcy principles govern chapter 11 reorganizations: (i) fresh start for debtors; (ii) fair and equitable treatment of creditors; (iii) debtor rehabilitation favored over liquidation; and (iv) economy of administration.

Bankruptcy law gives the debtor a "fresh start" by permitting the debtor to reorganize its affairs and permitting many debtors a discharge of debt. As stated by the Supreme Court in Local Loan Co. v. Hunt, "One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him a start afresh free from the obligations and responsibilities consequent upon business misfortunes."' [FN1]

Bankruptcy law protects creditors by requiring the orderly and fair collection and distribution of the debtor's estate. [FN2] In a reorganization case, the ***56** Bankruptcy Code requires the following for confirmation of a plan: (i) the plan must be proposed in good faith and not by any means forbidden by law; and (ii) the plan must be feasible and not likely to be followed by a liquidation or another reorganization. [FN3]

The Bankruptcy Code encourages reorganization over liquidation in the interest of economic stability. Congress has determined that rehabilitating a corporation is in the best long-term interest of creditors, shareholders and the public: it is more productive to use assets in the business for which they are designed than to sell assets on a liquidation **basis.** [FN4] In NLRB v. Bildisco the Supreme Court explained, "The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources." [FN5]

A bankruptcy petition gives debtors "breathing space" from creditors. All collection activity, including tax collection by the Internal Revenue Service is stayed. [FN6] Bankruptcy law [FN7] further protects the interests of creditors by requiring that expenses incurred by the debtor in furtherance of reorganization be kept to a minimum, "so as to preserve as much of the estate as possible." [FN8]

Bankruptcy tax law does not pervasively contradict these bankruptcy principles. Indeed, legislative history reveals that many bankruptcy tax provisions are intended to encourage reorganization over liquidation. The

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Treasury Department, however, does not consider only debtor rehabilitation. The Treasury sees itself as an involuntary creditor that cannot refuse to extend credit, cannot demand collateral, and therefore operates at a disadvantage to creditors generally. [FN9]

Several of the advantages enjoyed by taxpayers in bankruptcy contradict tax theory. With increasing success the Treasury has chipped away those advantages. In general, the Treasury maintains that the purpose of tax law is to ensure that all taxes are paid regardless of inconvenience to the taxpayer. [FN10] The Treasury would therefore prefer that any subsidies to business be direct and not at the cost of tax collection. [FN11]

***57** A Treasury statement submitted to the House Committee on Ways and Means during consideration of the Bankruptcy Tax Act of 1980 contains this concise summary of the Treasury's bankruptcy tax policy: [FN12]

(1) Clarification of the law. Many bankruptcy and insolvency tax provisions are "obscure" and should be clarified.

(2) Equal treatment in and out of bankruptcy. Recognizing that "there is the desire to afford special tax rules for those who appear to be in need," the insolvent debtor in bankruptcy should have no advantage over the insolvent debtor who has not filed a petition for bankruptcy.

(3) Fresh start but no head start. Debtors should not be entitled to reduce pre-bankruptcy tax liabilities while simultaneously retaining certain built-in tax benefits post-bankruptcy, such as a deduction for net operating loss carryovers from pre-petition tax years.

(4) Minimizing tax shelter abuse. Insolvency should not be a means to avoid recapture of tax shelter deductions for depreciation, investment tax credits, and similar items. [FN13]

(5) Simplicity and "administrability." Where there is a choice among reasonable alternatives, the simpler and more administrable approach should be adopted.

(6) Fairness and equity.

Among the stated policies, Bankruptcy policy and tax policy conflict most directly over the question of whether debtors should be allowed to reduce pre-bankruptcy tax liabilities and retain built-in tax benefits such as deductions against post-petition income for net operating loss carryovers from pre-petition years. The Treasury argues that such a policy constitutes an unwarranted subsidy, and gives debtors in bankruptcy a "head start" over similarly situated tax-payers not in bankruptcy. Congress permits some debtors this slight "head start" apparently because it views such tax advantages as a convenient way to promote rehabilitation over liquidation.

Congress' generosity to debtors has not been constant. The tax provisions governing net operating loss carryovers, corporate reorganizations in bankruptcy, and cancellation of indebtedness income have changed as the political will swings between the competing interests of rehabilitating troubled businesses and raising revenue. The uncertainty and confusion created by frequent changes to the ***58** tax law are compounded by the imperfect fit of tax law and bankruptcy law. Consequently, ambiguity is ingrained in bankruptcy tax law. Unfortunately, that ambiguity cannot be resolved in advance by the bankruptcy court considering approval of a debtor's plan of reorganization. Both tax law and bankruptcy law would be promoted by enactment of a provision in the Bankruptcy Code allowing bankruptcy courts to make advance determinations of the tax consequences of bankruptcy plans of reorganization.

CANCELLATION OF INDEBTEDNESS INCOME

Historical Background

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In bankruptcy reorganizations the debtor typically pays a percentage of its obligations to creditors, and is forgiven the balance - thus the debtor continues to operate its business with a fresh-start. [FN14] Generally, debt forgiveness creates income for taxpayers; [FN15] however, a debtor in bankruptcy obtains certain tax advantages. This section traces the history of the taxation of cancellation of indebtedness income in bankruptcy, with emphasis on the development of the present law. Professor Eustice has described the history of cancellation of indebtedness income as "at best complex and at worst nearly inscrutable." [FN16]

In U.S. v. Kirby Lumber [FN17] the Supreme Court ruled that retirement of debt at less than its face amount results in taxable income. In 1923 Kirby Lumber had issued bonds, which it repurchased the same year at a discount. Holding that the difference between the issue price and the discount price was taxable income, Justice Holmes observed that the taxpayer had realized an "accession to income," and that "there is not a shrinkage of assets to the taxpayer." [FN18]

In the midst of the Great Depression, several courts recognized an "insolvency" exception to Kirby Lumber: no income arose from a **discharge** of **indebtedness** ***59** if the debtor were insolvent both before and after the transaction. [FN19] In 1938, Congress amended the Bankruptcy Act of 1898 to provide a statutory insolvency exception which exempted cancellation of indebtedness income in a bankruptcy case from all income taxes, provided the debtor elected to reduce the **basis** of its assets. [FN20] To implement these changes in bankruptcy law, in 1939 Congress amended the tax code to exclude cancellation of indebtedness income from recognition in certain corporate reorganizations and to require **basis** reduction instead. [FN21] Thus, by 1940 the Bankruptcy Act and the Internal Revenue Code deferred cancellation of indebtedness income until the debtor's **reduced-basis** property was sold.

In 1940, the Bankruptcy Act again was amended to enhance the tax benefits of the insolvency exception by providing that a debtor in bankruptcy need only reduce the **basis** of its assets to the assets' fair market value. [FN22] No further reduction would be required for cancellation of indebtedness in bankruptcy, even though assets often have a tax **basis** lower than fair market value due to factors such as inflation and depreciation. More significantly, a debtor in bankruptcy did not have to reduce net operating loss carryovers or other tax attributes as a consequence of tax-free treatment. [FN23]

In 1943 Congress gave bankrupt corporations another helping hand by freeing assets from any **basis** reduction upon a debtor's receipt of cancellation of indebtedness income in an acquisitive reorganization under Chapter X of the Bankruptcy Act. Specifically, former sections 371 and 372(a) [FN24] provided that **basis** would not be reduced as a consequence of realization of cancellation of indebtedness income if a debtor's plan of reorganization called for a transfer of assets to a successor corporation (net operating losses, however, did not carryover). Even if the debtor's reorganization did not involve a successor corporation, **basis** reduction under Chapter X could be avoided under the stock for debt exception described below. [FN25]

Cancellation of Indebtedness Under The Bankruptcy Tax Act of 1980 and the Tax Reform Act of 1986

Concerned that debtors in bankruptcy be entitled to a fresh-start, but not ***60** to defer tax forever, [FN26] the Bankruptcy Tax Act of 1980 marked the end of the more liberal treatment of **discharge** of **indebtedness** income and specifically repealed the "judicial insolvency exception". [FN27]

Generally, § 108(a) excludes cancellation of indebtedness income from gross income for insolvent debtors in bankruptcy. [FN28] Section 108(b) reduces the debtor's tax attributes by the amount of the canceled debt. [FN29] Most significant, deductions against income for net operating loss carryovers must be reduced.

A debtor may elect instead to apply all or any portion of the cancellation of indebtedness income to reduce the **basis** of depreciable property before reducing deductions such as net operating losses. [FN30] These rules apply to debtors in bankruptcy and to other debtors to the extent they are insolvent. [FN31]

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In the absence of an election to reduce **basis,** tax attributes are reduced in the following order:

(1) Net operating losses for the taxable year of the discharge and any net operating loss carryovers; [FN32]

(2) Carryovers of tax credits, including the research credit [FN33] and the general investment tax credit [FN34] (at the rate of 33 1/3 cents for each dollar of debt cancellation) [FN35] but not the employee's stock ownership plan credit; [FN36]

(3) Net capital loss for the taxable year of discharge [FN37] and any capital loss carryover; [FN38]

(4) **Basis** of the debtor's depreciable and non-depreciable assets in accordance with regulations; [FN39] and

(5) Foreign tax credit carryovers [FN40] at the rate of 33 1/3 cents for each dollar of debt cancellation. [FN41]

***61** Note that passive activity loss credit and credit carryovers [FN42] and the minimum tax credit [FN43] are not reduced. [FN44]

At least one spokesman suggested during the hearings on the Bankruptcy Tax Act of 1980 that the order of attribute reduction should be geared more to the rehabilitation of debtors. [FN45] If a debtor were allowed to choose the order in which attributes are reduced, the debtor could ensure full use of expiring attributes. This would be especially helpful in the case of net operating losses which must be reduced on a last in - first out (LIFO) **basis** rather than first in - first out (FIFO).

Debtor/taxpayers who elect to reduce the **basis** of depreciable property before reducing tax attributes must reduced the full amount of the adjusted **basis** of depreciable property, but not below zero. [FN46] After the **basis** of depreciable property is reduced to zero, any remaining cancellation of indebtedness income is subject to the rules for reducing tax attributes. [FN47] If, after all these adjustments, some amount of discharged debt has not yet been offset, no tax is imposed on the excess. [FN48]

"Depreciable property" means any property subject to depreciation, including real property held as inventory. [FN49] Adjusted **basis** of depreciable property is reduced in the following order:

(1) **Basis** of property acquired with purchase money debt is reduced by the canceled amount of such debt;

(2) **Basis** of property subject to a lien securing a debt is reduced by the canceled amount of such debt;

(3) **Basis** of each property item of the debtor is reduced pro rata by an amount equal to the proportion that the **basis** of each property item bears to the sum of the **basis** of all the debtor's property; and

(4) **Basis** of inventory, notes and accounts receivable are reduced in the proportion that the **basis** of each item bears to the sum of the **basis** of all of those items. [FN50]

***62** In deciding whether to reduce tax attributes or to reduce **basis,** the debtor must weigh (a) the advantages of using loss and credit carryovers to offset immediate post-petition income against (b) the disadvantages of (1) exhausting additional tax attributes; (2) foregoing depreciation reductions, thus increasing taxes in later years; and (3) (especially under the pre-1986 Code) losing the opportunity to offset capital loss carryovers against ordinary income. [FN51] Further, net operating losses have a useful life of fifteen years, and must be used or they are lost.

For example, if a debtor has net operating loss carryover deductions which are about to expire, but does not anticipate sufficient short term income to exhaust those deductions, the debtor must use those deductions immediately to offset cancellation of indebtedness income, because the net operating losses carryovers will

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otherwise expire before they can be used as a deduction against income. On the other hand, if the debtor does not anticipate losing net operating loss carryovers through non-use, the debtor should elect to reduce the **basis** of its assets first to offset cancellation of indebtedness income, because such reduction will not be recaptured until the assets are sold, and the debtor's net operating losses can be used freely in the meantime to offset earned income.

Any gain on subsequent transfers of assets with **basis** reduced under § 108 [FN52] is subject to recapture [FN53] as ordinary income under §§ 1245 and 1250, [FN54] which are designed to prevent conversion of ordinary income into capital gains. [FN55] Because the Tax Reform Act of 1986 eliminated any reduction of tax liability for capital gains, as opposed to ordinary income, the concern whether ordinary income is converted into capital gains is reduced after the Tax Reform Act of 1986. This is not to say that the ordering rules serve no purpose; to the extent the ordering rules limit reductions to **basis** of intangible assets, such as goodwill, the rules prevent indefinite deferral of taxes. [FN56]

The Stock for Debt Exception

Exchanges of stock for debt are an historical exception to the cancellation of indebtedness rules. It has long been the case law that no cancellation of indebtedness income is realized by an insolvent corporate debtor if stock is issued ***63** in exchange for debt, even if the stock is worth less than the face amount of the obligation satisfied. [FN57] The stock for debt exception was based on the theory that the substitution of stock for debt constitutes a creditor's continued investment in the corporate debtor, and recognition of cancellation of indebtedness income would be inappropriate. [FN58]

The Bankruptcy Tax Act of 1980 codified in § 108(e)(8) the stock for debt exception to cancellation of indebtedness income recognition. [FN59] In 1984 the stock for debt exception was narrowed to include only debtors in bankruptcy, and other insolvent debtors to the extent a debtor is not made solvent by the stock for debt exchange. [FN60]

Stock for Debt Limitations

The Bankruptcy Tax Act of 1980 imposed two limitations on the common law stock for debt exchange exception. Under the "de minimis" rule, the stock for debt exception does not apply if, considering "all the facts and circumstances," the stock issued consists of a nominal or token amount of shares. [FN61]

Where stock and other consideration is issued to a creditor, the legislative history to the Bankruptcy Tax Act of 1980 from the House of Representatives suggested that the stock should be treated as satisfying "a proportion of the debt equal to its proportion of the value of the total consideration." [FN62] In contrast, the legislative history in the Senate suggests that the stock should be treated as satisfying the debt remaining after first offsetting the other consideration against the debt. [FN63] The greater the amount of debt offset by stock, the ***64** less the debtor must reduce tax attributes and **basis** of assets. Thus, the Senate approach is more favorable to debtors. Comments by Congressman Ullman, Chairman of the House Ways and Means Committee, upon introducing the Bankruptcy Tax Act of 1980 indicate that the House accepted the Senate approach. [FN64] Further, the Senate approach is consistent with pre-1980 law. [FN65]

To satisfy the de minimis rule, at least two commentators suggest by analogy to the regulations under § 351 [FN66] that the value of stock exchanged for debt should equal at least 10% of the debt. [FN67] The Internal Revenue Service has confirmed that stock exchanged for debt with a value of 10% of the debt is acceptable. In a letter ruling [FN68] the Service applied the Senate approach to a case in which the debtor distributed both cash and stock, and approved the debtor's use of the stock for debt exception where the fair market value of the stock distributed represented 10% of the amount by which the claims exceeded the cash component of the distribution.

The Service considered the following factors in determining whether the stock transferred in exchange for debt was "nominal or token": (i) the presence of arms length bargaining involving adverse economic interests between

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 261

debtor and creditors; (ii) the value of the stock relative to the face amount of the debt canceled; and (iii) the value of the stock relative to the value of other consideration received in discharge of the debt. The Service found that creditors received twice the liquidation value of the debtor and (i) that adverse interests existed inasmuch as creditors released their right to force a liquidation, and the debtor had to convince creditors "that the stock used in the exchange represented the greatest economic value available to the creditors"; (ii) the stock amounted to about 10% of the debt canceled in the exchange; and (iii) the stock represented about 15% of the total consideration received.

In general, adverse economic interests between the debtor and creditors is an easy element to satisfy in any bankruptcy case. The Service's second test-that the value of stock received by creditors be measured against the face amount of debt discharged-can be problematic. If all creditors are receiving a very small distribution in a case, creditors who are receiving stock with a value of less than 10% of the debt discharged in exchange for debt may appear to be violating the nominal or token rule requirement. For example, if a bankruptcy plan pays certain creditors nine cents cash on the dollar, and certain other creditors receive stock with a value of nine cents for each dollar of claim, ***65** both groups of creditors are treated equally; however, the Service may nonetheless consider that the creditors with stock obtained a "nominal" or "token" distribution.

The better view compares the value of stock exchanged for debt to the value of other consideration received by similarly situated creditors for their debt. In other words, the value of stock exchanged for debt should be at least one-tenth of the value of other consideration received by similarly situated creditors. [FN69] In the letter ruling, all general unsecured creditors were treated alike, leaving no **basis** for comparison. If under a bankruptcy plan certain creditors are paid thirty cents cash on the dollar, payment in stock to similarly situated creditors should not be considered nominal or token unless the value of that stock is less than one tenth of thirty cents on the dollar, or 3 cents per each dollar of claim.

The third requirement is new: the Service measured the value of stock received by a creditor against the value of other consideration received by that creditor. For example, if a debtor proposes to establish one class of general unsecured creditors who are to be paid $.75 cash for each dollar of debt, the debtor will have to reduce either its asset **basis** or tax attributes by $.25 of canceled debt. If on the other hand, the debtor proposes to pay general unsecured creditors $.72 cash and stock valued at $.03 for each dollar of debt, the debtor will argue that it realizes no cancellation of indebtedness income under the stock for debt exception. The debtor will have satisfied the 10% rule under the Senate approach because the value of the stock ($.03) is more than 10% of the value of the debt discharged therefor ($.25). Thus the debtor will not have to reduce its asset **bases** nor reduce tax attributes. The Service might nonetheless disallow the stock for debt exception treatment because the consideration representing stock ($.03) is only 4% of the total consideration creditors receive ($.75). In the letter ruling, the Service approved consideration representing stock in the amount of 15% of total consideration but the Service did not set forth any bright line test.

Proposed Treasury Regulation § 1.108-1 would adopt the reasoning set forth in the letter ruling, and would create the following measurements for applying the de minimis rule:

(i) Stock to debt ratio - ratio of the fair market value of stock transferred to a creditor to the amount of **discharged indebtedness** allocable to that stock;

(ii) Stock to total consideration ratio - ratio of the fair market value of stock transferred to a creditor to the fair market value of the total consideration received by that creditor; and

***66** (iii) Stock to total stock ratio - ratio of the fair market value of the stock transferred to all creditors to the total fair market value of all the corporation's outstanding stock after the bankruptcy or insolvency workout.

For example, assume that a plan of reorganization provides for each dollar of debt $.20 in cash, $.20 in new

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debt and $.05 of stock, and that former creditors collectively obtain 25% of the debtor's stock. The stock to debt ratio is 5%, the stock to total consideration ratio is 11%, and the stock to total stock ratio is 25%.

The proposed regulations provide for the following safe harbors:

(i) 10 percent stock to debt ratio and 25 percent stock to total consideration ratio;

(ii) 25 percent stock to total consideration ratio and 25 percent stock to total stock ratio; and

(iii) With respect to unsecured creditors, 100 percent stock to total consideration ratio and 90 percent stock to total stock ratio.

In addition to the de minimis rule, the stock for debt exception is not applicable to debt held by an unsecured creditor unless the ratio of (1) the value of the stock received by the creditor to (2) the amount of debt canceled in exchange for the stock is at least 50% of a similar ratio computed for all unsecured creditors receiving stock in the reorganization. [FN70] This is the "proportionality rule."

Violation of the proportionality rule creates a "cliff effect" triggering substantial realization of income by the debtor. For example, if creditor A held $1,000 of unsecured debt of the corporation and in a workout the corporation fully satisfied $10,000 of its unsecured debt with $6,000, A must receive 50% of the pro rata distribution received by the other creditors - in this case, 50% of the 60% pro rata distribution, i.e. 30% of his claim in stock, with a value of $300. If A receives stock with a value of only $250, the corporation realizes cancellation of indebtedness income equal to the difference between A's claim ($1,000) and the value of the stock ($250). Thus the corporation would recognize $750 of income as a consequence of underpaying $50 in stock. [FN71]

The Revenue Reconciliation Act of 1990 added another limitation on the stock for debt exception to the cancellation of indebtedness income rules. Preferred stock issued under a plan of reorganization does not qualify for the stock for debt exception under § 108(e)(10) if: (i) such stock has a fixed liquidation amount, (ii) the issuer of such stock has the right to redeem such stock at one ***67** or more times, or (iii) the holder of such stock has the right to require its redemption at one or more times.

The outright prohibition on the use of preferred stock with such attributes is puzzling. Presumably, the intent behind the legislation is to limit the use of preferred stock to discharge debt to the extent that the preferred stock could be redeemed at less than the amount of the debt discharged. Indeed Revenue Ruling 90-87 and the new proposed regulations interpreting the "nominal or token" limitation to the stock for debt exception announce this more reasonable position. The contradiction between the new statute and the proposed regulations may require judicial or legislative resolution.

Recapture

A creditor that receives stock of a debtor corporation in exchange for debt is subject to the recapture rules on subsequent disposition of the stock of § 1245 [FN72], a controversial provision now partially obsolete in light of the Tax Reform Act of 1986, and the elimination of the deduction for capital gains. To the extent creditors can recognize capital losses because of capital gains, the provision remains important.

Timing of Stock for Debt Exchanges

The tax stakes riding on the timing of stock for debt exchanges require identification of:

1. the year creditors owning securities realize gain or loss;

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 263

2. the date that an ownership change occurs for net operating loss carryover purposes;

3. the year cancellation of indebtedness income arises;

4. the year interest on old debt ceases to accrue; and

5. for consolidated returns, the year ownership of the debtor falls below the necessary 80% level. [FN73]

Timing of stock for debt exchanges could be affected by the Bankruptcy Code. [FN74] Upon confirmation of a chapter 11 plan of reorganization, claims against the debtor are discharged. [FN75] The "effective date of the plan", however, usually occurs sometime after confirmation, to allow for passage of the time for appeals. The date of discharge could be separated in time from the date of the exchange. No authority prescribes the tax significance of this separation in time. [FN76]

***68** The Contribution To Capital Exception

The contribution to capital exception to recognition of **discharge** of **indebtedness** income, which also arises from case law, applies to creditors who are shareholders. [FN77] If a creditor/shareholder's debt is contributed to the capital of the debtor corporation, the corporation is deemed to have satisfied the debt with money equal to the shareholder's adjusted **basis** in the debt. [FN78] If the shareholder's **basis** in the debt is less than the amount due, the corporation realizes cancellation of indebtedness income equal to the difference.

The contribution to capital exception raises a number of issues. First, should a corporate debtor's tax consequences be dependent upon the accounting practices of its creditors? In General Utilities [FN79] and Moline Properties [FN80] the Supreme Court held that a corporation is a separate entity for tax purposes. The contribution to capital exception appears to contradict General Utilities and Moline Properties insofar as it couples the "outside" recognition by creditors to the "inside" recognition of debtors. Determining recognition by creditors could be an onerous if not impossible compliance burden to impose upon corporate debtors. [FN81]

Commentators raise additional issues: Does it matter if the ownership of stock by a creditor is so unrelated to the cancellation of debt that the cancellation should not be considered a contribution to capital? Can the Service recharacterize a stock for debt exchange as a contribution to capital to force realization? If all the stock of a debtor corporation is held by its sole shareholder, will the contribution to capital rule apply if the creditor cancels the debt without having the corporation issue additional shares? Will the stock for debt exception apply if additional shares are issued? [FN82]

Debt Security for Debt Security Changes

Generally, in any debt security exchange in an insolvency situation, the new debt security has a lower face amount than the old debt security. Ordinarily, the difference between the issue price of an old and a new debt security would be treated under the cancellation of indebtedness provisions of Internal Revenue Code § 108. Due to inadvertence, however, until very recently, Internal Revenue Code § 1275(a)(4) essentially deemed the issue price of the new debt security to be the same as the old debt security. Thus, no cancellation of indebtedness income arose.

***69** The Revenue Reconciliation Act of 1990 repealed § 1275(a)(4). Section 108(e)(11) now provides that cancellation of indebtedness income is created upon the exchange of a debt security for a debt security to the extent that the adjusted issue price of the old debt exceeds the issue price of the new debt. To determine the "issue price", adjustments are made to account for that portion of the debt security which the Service deems to be interest rather than principal. That portion is called "original issue discount," and is calculated under §§ 1273 and 1274.

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The repeal of § 1275(a)(4) was occasioned in part by In re Chateaugay Corp., [FN83] in which the court applied original issue discount principles to fix the amount of secured claims.

The House Ways and Means Committee Report accompanying the 1990 Revenue Reconciliation Act illustrates the treatment of an exchange of publicly traded debt:

> A corporation issued for $1,000 a bond that provided for annual coupon payments based on a market rate of interest. The bond is publicly traded. Some time later, when the old bond is worth $600, the corporation exchanges the old bond for a new bond that has a stated redemption price at maturity of $750. The exchange is treated as a realization event under section 1001. Under the bill, the new bond will have an issue price of $600 (the fair market value of the old bond) and deductible OID of $150 ($750 stated redemption price at maturity less $600 issue price) and the corporation will have COD of $400 ($1,000 adjusted issue price of the old bond less $600 issue price of the new bond). Such results will occur whether or not the exchange qualifies as a reorganization. [FN84]

It should be noted that section 108(e)(11) does not apply to bankruptcy cases filed on or before October 9, 1990, or to transactions before that date.

Bankruptcy Tax Policy

Background

The insolvency exception to cancellation of indebtedness income has been criticized for its logical inconsistencies. Kirby Lumber, which requires recognition of cancellation of indebtedness income, is premised on the principle that taxpayers enjoy a "net accretion to wealth". Subsequent relaxation of the Kirby Lumber doctrine presupposes that insolvent debtors do not enjoy a net accretion to wealth through debt cancellation. Better economic analysis would look ***70** to the benefits taxpayers obtain when a loan is issued (no includible income) and the need to balance that noninclusion of income with a corresponding recognition of income upon loan forgiveness. [FN85] Simply stated, the economic benefit derived from debt forgiveness is no different than the economic benefit derived from other sources of income, such as salary. This economic analysis is especially pertinent if the debtor has obtained a tax deduction for the expenditure of the amount forgiven, or if the creditor can take a tax loss for the debt forgiveness. [FN86]

Nonetheless, the insolvency exception in general and the stock for debt exception in particular are very important to debtor rehabilitation. To the extent that a debtor can persuade creditors to take stock instead of cash as part of a plan, the debtor is better able to maintain adequate cash flow to finance operations and capital expenditures, and to secure credit. [FN87] Despite the inconsistency between tax policy and bankruptcy policy, the insolvency exception persists to promote debtor rehabilitation.

The inevitable byproduct of the mixture of bankruptcy and tax law, as well as the constant changes to that mixture, is uncertainty. For example, the timing of a stock for debt exchange is governed by a variety of bankruptcy considerations not present in nonbankruptcy transactions. The changes made by the Bankruptcy Tax Act of 1980 were superseded by the Tax Reform Act of 1986, before the 1980 changes were fully understood by lawyers. Uncertainty is a hindrance to debtor reorganizations, and supplies one argument to permit advance determination of tax consequences of bankruptcy reorganizations.

Tax Policy

Clarification of the Law. Under the Bankruptcy Tax Act of 1980 and subsequent legislation, the rules for treatment of cancellation of indebtedness income have been clarified, but confusing issues still arise under the stock for debt exception: (i) whether solvent debtors in bankruptcy qualify; (ii) how much debt must be exchanged for stock to qualify; (iii) how much debt is deemed satisfied for stock when a creditor is given both stock and

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cash; (iv) when the exchange of stock for debt is deemed completed; (v) whether stock for debt exchanges can be recharacterized as a contribution to capital, and (vi) how to treat debt security for debt security exchanges.

Equal Treatment In and Out of Bankruptcy. Generally, the insolvency exception and the stock for debt exception apply to insolvent debtors and debtors in bankruptcy. However, § 108 of the Internal Revenue Code allows solvent and *71 insolvent debtors in bankruptcy the same tax advantages (although the stock for debt exception may not apply to solvent debtors). The Treasury would probably sense unfairness in allowing solvent debtors in bankruptcy to enjoy tax advantages relating to cancellation of debt not enjoyed by debtors struggling to avoid bankruptcy.

Fresh Start But No Head Start. The rules governing cancellation of indebtedness income give debtors in bankruptcy a "head start" in the following ways: (i) the election to reduce **basis** of assets in lieu of reducing tax attributes as a consequence of realization of cancellation of indebtedness income allows debtors in bankruptcy and insolvent debtors to retain built-in tax attributes while reducing tax liabilities; (ii) the stock for debt exception goes further and does not even require that the **basis** of assets be reduced as a consequence of realization of **discharge** of **indebtedness** income (although net operating loss carryovers could be reduced); (iii) the contribution to capital exception permits debtors to retain tax attributes but potentially realize little income upon the cancellation of indebtedness.

Simplicity and Administrability. As described more fully below, [FN88] the Internal Revenue Service has many opportunities to assert its position in a bankruptcy reorganization. The Service can object to a debtor's plan. The Service can also seek a bankruptcy court decision regarding the propriety of the debtor's treatment of **discharge** of **indebtedness** income and other tax issues. If the Service disagrees with the bankruptcy court, the Service can deny the debtors the treatment approved by the bankruptcy court. Debtors cannot, however, obtain a binding ruling prospectively. That the Service has its cake and eats it too with respect to bankruptcy tax determinations seems eminently "administrable" from the Service's point of view, but repetitive administrative reviews following the bankruptcy court's decision are wasteful and unnecessary.

Fairness and Equity. The fairness and equity of the **discharge** of **indebtedness** provisions ultimately turns on one's view of the policy balance between orthodox tax theory and the rehabilitation of troubled businesses. The provisions are unfair, however, to the extent that the Service has a procedural advantage over debtors in obtaining binding preconfirmation rulings upon the tax treatment of the debtor's plan.

Bankruptcy Policy

Fresh Start. The debtor's fresh start is promoted because debtors may elect to reduce **basis** of assets instead of reducing net operating loss carryovers as a consequence of **discharge** of **indebtedness** income. In this way, net operating losses are preserved for the use of the debtor.

*72 Fair and Equitable Distribution Among Creditors. In general, the insolvency exception does not affect the debtor's ability to distribute its assets fairly among creditors. Arguably, however, the proportionality rule limits the ability of creditors to agree to certain distributions of the debtor's assets. For example, there is no economic reason why a creditor should not be permitted to accept consideration for its claim in the form of stock, which stock is valued at less than 50% of the value of non-stock consideration to which similarly situated creditors are entitled.

Rehabilitation Favored Over Liquidation. The insolvency exception clearly promotes rehabilitation over liquidation to the extent that debtors are entitled to reduce **basis** of assets instead of losing tax attributes such as net operating loss carryovers. The stock for debt exception promotes rehabilitation even more effectively by allowing debtors to discharge debt without reducing the **basis** of assets or tax attributes. Rehabilitation is hindered by the debtor's inability to determine conclusively whether it qualifies for the stock for debt exception, how much debt is deemed satisfied for stock, the timing of the exchange, and the tax characterization of the exchange.

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 266

Economy of Administration. As argued more fully below, [FN89] it is not economical to administer bankruptcy tax law in the bankruptcy court if the findings of the bankruptcy judge do not bind the Service. The current procedure frustrates confirmation of plans and fosters repetitious litigation.

"G" REORGANIZATION

Historical Background

Under conventional tax principles, the sale or disposition of all of a corporation's assets to a successor corporation is a taxable transaction which should result in the recognition of taxable gain or deductible loss, [FN90] and the disappearance of loss carryovers of the former corporation. [FN91] In 1918, however, Congress provided for non-recognition of gain and loss if such sales were structured as exchanges of stock for stock, [FN92] and followed in 1924 with a provision for the inheritance of **basis,** [FN93] and finally in 1954 with the preservation of loss carryovers in the hands of the surviving corporation. [FN94]

Prior to 1934 the term "reorganization" was defined for tax law purposes as:

> A merger or consolidation (including the acquisition by one corporation of . . . substantially all the properties of another corporation). [FN95]

***73** Courts soon narrowed the definition to make outright sales taxable, but preserved tax-free treatment for mere adjustments of existing ownership interests. To distinguish sales from tax-free reorganizations, the courts prescribed that for reorganizations, pre-change shareholders must retain a substantial stock interest in the post-change corporation. [FN96] This became known as "continuity of interest," and in 1934 the rule was incorporated into the Internal Revenue Code. [FN97]

Continuity of interest was difficult to achieve in bankruptcy reorganization of cases under the tax rules requiring shareholders to retain a substantial stock interest, because shareholders are usually entitled to little or no consideration in the reorganization of an insolvent corporation as they are last in the "priority" line. Creditors effectively control the reorganization and assume the shareholders' position. As described more fully below, [FN98] the courts have allowed tax-free reorganizations for bankrupt corporations, if creditors obtain the stock which would otherwise remain in the hands of shareholders.

In 1942 the Supreme Court added a new element to continuity of interest. In Southwest Consolidated Corp. [FN99] the court denied tax free treatment for the reorganization of an insolvent corporation that distributed some cash to creditors and former shareholders in addition to voting stock. A year later, Congress added the Southwest Consolidated rule to the predecessor to §§ 371 and 372 of the 1954 Internal Revenue Code. For bankruptcy reorganizations, only stock could constitute consideration for tax free treatment, and net operating losses did not carry over.

"G" Reorganizations Under The Bankruptcy Tax Act of 1980

The Bankruptcy Tax Act of 1980 freed insolvency reorganizations from the "solely for stock" provisions of the 1954 Code, and, with a few exceptions, debtors in bankruptcy now enjoy the same tax-free reorganization rules generally applied to solvent corporations. [FN100] Specifically, Congress created the "G" reorganization. [FN101] Legislative history indicates that the "G" reorganization rules are intended "to facilitate the rehabilitation of corporate debtors in bankruptcy, and to eliminate many requirements which have effectively precluded financially troubled companies from utilizing the generally applicable tax-free reorganization provision of present law." [FN102]

***74** Continuity of Interest

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Notwithstanding the enactment of the "G" reorganization under the Bankruptcy Tax Act of 1980, and the repeal of §§ 371 and 372 of the 1954 Internal Revenue Code, the continuity of interest doctrine persists. The legislative history states:

> [T]he "continuity of interest" requirement which the courts and the Treasury have long imposed as a prerequisite for non-recognition treatment for a corporate reorganization must be met in order to satisfy the requirements of new category "G". [FN103]

To satisfy the continuity of interest requirement, and thereby realize treatment as a reorganization rather than a sale, not all of the consideration has to be stock, but a substantial percentage of the consideration to the selling stockholders (creditors) must be qualifying equity interests rather than cash or debt instruments. [FN104] The Internal Revenue Service has stated that it will not issue a private letter ruling regarding any transaction where stock represents less than 50% of the consideration received by old stockholders (creditors). [FN105] Although case law allows less than 50%, [FN106] prudence dictates that debtors strive for 50% continuity of interest.

A pre-1980 regulation for non-recognition treatment provides that in bankruptcy reorganizations creditors stand in shareholders' shoes for purposes of calculating the percentage of consideration received as equity:

> [F]or the purpose of determining whether the requisite continuity of interest exists, the interests of creditors who have by appropriate legal steps, obtained effective command of the property of an insolvent corporation is considered as the equivalent of a proprietary interest . . . . The determinative and controlling factors are the corporation's insolvency and the effective command by the creditors over its property. [FN107]

Treatment of creditors as shareholders for continuity of interest purposes in bankruptcy reorganizations dates from Helvering v. Alabama Asphaltic Limestone Company. [FN108] In Alabama Asphaltic creditors of an insolvent corporation created a new corporate entity to acquire the assets of the involuntary corporate debtor in bankruptcy. With the approval of the bankruptcy court, the creditors acquired the stock of the new corporation in exchange for their claims, ***75** and the shareholders' interest was eliminated. The Service argued that the series of transactions could not fit within the statutory definition of a "reorganization" because the former shareholders were eliminated and therefore had no continuing interest in the surviving corporation. The court held that, by initiating the involuntary bankruptcy proceedings, creditors "stepped into the shoes" of the shareholders and were the true owners of the debtor's equity.

In a "G" reorganization, stock received by both shareholders and creditors counts for continuity of interest compliance. More support is found in the legislative history to the Bankruptcy Tax Act of 1980:

> [S]hort term creditors who receive stock for their claims may be counted toward satisfying the continuity of interest rule, although any gain or loss realized by such creditors will be recognized for income tax purposes. [FN109]

The legislative history also addressed exactly which creditors should be counted towards the required continuity. Under pre-1980 law the "absolute priority" [FN110] rule applied, and claims with the most seniority or security had to be satisfied in cash before claims with less seniority or security. Holders of claims that could be satisfied in full with cash therefore did not count toward continuity of interest. Thus, continuity of interest was measured by the stock received by the most senior class of creditors that could not be paid in full in cash. [FN111]

Legislative history suggests that measurement of continuity after the Bankruptcy Tax Act of 1980 should account for all classes of creditors and shareholders that take distribution below and including the most senior class obtaining shares of stock as part of the debtor's plan of reorganization - the "relation back" approach. [FN112] Payment in both cash and stock to senior creditors does not destroy continuity of interest.

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For example, if a reorganization plan provides for (i) payment in cash to senior secured creditors, (ii) payment in stock to certain junior secured creditors and payment in cash to certain junior creditors, (iii) payment in cash and stock to all general unsecured creditors and (iv) payment in stock to shareholders, the plan will satisfy the relation back approach. The class of creditors with at least one member receiving stock is the class of junior secured creditors, and all members of all classes junior to the junior secured creditors will receive some stock.

***76** The only other source of authority for the relation back approach is two private letter rulings concerning non-bank "G" reorganizations. In the more pertinent ruling, the Service applied the relation back approach and approved a distribution of stock to creditors and shareholders. The measuring group included "all members of any of those classes of creditors having a priority in bankruptcy (as set forth in the Bankruptcy Code) equal to or lower than that of the highest class of creditors to have at least one member acquiring preferred stock." [FN113]

The second private letter ruling involved the acquisition of a debtor by the guarantor of the largest claim against the debtor. [FN114] The guarantor paid all of the debtor's creditors in cash, and exchanged stock for the debt that the corporation had guaranteed. The transaction appears to be a reorganization in lieu of a foreclosure. The Service approved the transaction because the value of the stock distributed under the plan of reorganization was equal to 50% of the value of all of the claims. The Service treated the creditor as if it were a shareholder and treated the creditor's claim as shareholder equity.

The most obvious drawback to the relation back approach is that it limits the mix of consideration that plans of reorganization can provide. For example, the issuance of stock to a very senior class of creditors means that all (not some) junior classes must be counted as equity holders for continuity of interest purposes. In the interest of rehabilitation, debtors and creditors would prefer that stock be distributed to creditors on the **basis** of a plan negotiated among the parties without regard to the relation back approach or strict priority. Economically it makes little difference which creditor takes stock and which does not. [FN115] The only danger to the Treasury in allowing unrestricted distribution of stock to creditors is that a class of creditors (perhaps a class with only one member) could effectively buy the debtor and take a carryover **basis** in its assets. The problem is easily remedied by statute. Notwithstanding its shortcomings, the relation back approach has generally been a practical and workable solution to the problem of determining how to treat creditors as shareholders for continuity of interest purposes.

Business Purpose and Continuity of Business Enterprise

A "G" reorganization must also have a "business purpose" [FN116] and must involve a "continuity of the business enterprise under the modified corporate form. [FN117] With regard to business purpose, the reorganization should not be a step toward a sale or liquidation. [FN118] With regard to continuity of business ***77** interest, the successor corporation does not have to engage in the same business, so long as there is continued use of the transferor's "historic business" or a "significant part" for a sufficient period. [FN119] The "G" Reorganization private letter rulings typically state that the debtor's business will continue "in a substantially unchanged manner" after consummation of the transaction.

Distribution Requirement

To qualify as a "G" reorganization, a debtor corporation must distribute stock or securities in exchange for its assets in a transaction qualifying under §§ 354, 355 or 356 of the Internal Revenue Code. [FN120] This distribution requirement assures that "either substantially all of the assets of the financially troubled corporation, or assets which consist of an active business" will be transferred to the acquiring corporation. [FN121]

Section 354. Section 354 provides that no gain or loss shall be recognized in an exchange of "stock or securities" for "new stock or securities". [FN122] Hence, the continuity of interest problem reappears. Tax law considers tax-free corporate reorganizations to involve the exchange of stock for stock. In bankruptcy reorganizations, debtors often seek to satisfy the claims of creditors with stock. That manner of exchange does not

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generally give rise to a tax-free reorganization under the tax law.

The same reasoning that gives debtors in bankruptcy an exception to the continuity of interest rule, however, gives debtors in bankruptcy an exception to § 354(a). The legislative history indicates that compliance with § 354 was not intended to have the same meaning for bankruptcy tax reorganizations as it does for other corporate tax reorganizations. [FN123] In bankruptcy cases the creditors of a debtor are deemed to have stepped into the shoes of shareholders. Thus an exchange of creditors' claims for the debtor's stock is deemed to be an exchange of stock for stock under § 354.

Further, the private letter rulings cited above suggest that creditors can stand in the shoes of shareholders for purposes of § 354(a) continuity. For example, in a recent letter ruling a "G" Reorganization was approved despite the fact that former shareholders obtained no stock or other consideration on account of their shareholder status. [FN124]

One letter ruling suggests, however, that "at least one person or entity" should exchange stock for stock to qualify. [FN125] This limitation, if imposed ***78** rigorously, would restrict "cram down" "G" reorganizations. Cram down under § 1129(b)(1) of the Bankruptcy Code allows debtors to confirm a plan over the dissent of an "impaired" class of interests provided, among other things, that no junior class takes any consideration. If a shareholder must take stock in a "G" reorganization, insolvent debtors would be unable to cram down any class of interests senior to shareholders.

The requirements of § 354(b) must also be satisfied: the debtor must distribute "substantially all of the assets" to the acquiring corporation, and the "stock, securities, and other properties" received by the debtor must be distributed in "pursuance of the plan of reorganization." [FN126] In effect, the debtor must liquidate. For advance ruling purposes, the Internal Revenue Service requires that the transferor (debtor) corporation transfer at least 70% of its gross assets and 90% of its net assets. [FN127] The cases interpreting the "substantially all" test have allowed smaller percentages. [FN128]

Fixed percentages and "bright line" tests for the application of the "substantially all" test to bankruptcy reorganizations conflict with the reality of an insolvent corporation. In many instances unprofitable divisions must be disposed of even before a plan of reorganization is proposed. In other cases, individual assets must be sold during the bankruptcy case to raise cash. [FN129] The 1980 legislative history recognized these problems and suggested a case by case approach:

> The "substantially all" test in the "G" reorganization provision is to be interpreted in light of the underlying intent in adding the new "G" category, namely, to facilitate the reorganization of companies in bankruptcy or similar cases for rehabilitative purposes. Accordingly, it is intended that facts and circumstances relevant to this intent, such as the insolvent corporations need to pay off creditors or to sell assets or divisions to raise cash, are to be taken into account in determining whether a transaction qualifies as a "G" reorganization. For example, a transaction is not precluded from satisfying the "substantially all" test for purposes of the new "G" category merely because, prior to the transfer to the acquiring corporation, payments to creditors and asset sales were made in order to leave the ***79** debtor with more manageable operating assets to continue its business. [FN130]

To some degree the Service apparently accepts a relaxed interpretation of § 354(b) for bankruptcy reorganizations. In one of the private letter rulings discussed above, the Service approved the debtor's disposal of assets to finance its operations and minimize its losses, until the time, the "Trustee first determined that Target could not be viably operated as an independent going concern, concluding that an internal reorganization was impractical." [FN131]

The letter ruling determination of whether "substantially all" of the debtors assets were transferred turned on when the debtor's management decided that the debtor could not survive as an independent entity. If applied

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broadly, this analysis requires that a debtor be circumspect about when it decides to reorganize:

> [I]t becomes extremely important to cut square corners regarding the time at which such an intent is formulated. The failing company and its trustee should avoid contingency planning speculations about the possibilities of two-company reorganizations until the last moment at which it becomes necessary to abandon the thought of rescuing the company through a one-company internal recapitalization. [FN132]

The Treasury's interest in simplicity is promoted by its measurement of "substantially all" from the date that a debtor cannot survive independently. On the other hand, the bankruptcy policy of encouraging rehabilitation is deterred. Disposing of assets after deciding that a company cannot survive independently does not, of itself, mean that less than substantially all of the assets of a corportion will be transferred in a subsequent disposition. Nor does it suggest a failure to transfer assets which consist of an active business to the acquiring corporation. [FN133] The determination of whether sufficient operating assets to continue the debtor's business are transferred as part of a "G" reorganization [FN134] can be better based on a facts and circumstances test. For example, whether a pre-transfer disposition of assets resulted from a debtor's business judgment or whether the disposition was the result of prompting from the acquiring corporation is a question of fact which can only be decided on a case-by-case **basis.** [FN135]

***80** Section 355. Generally, a reorganization under § 355 involves the reshuffling of corporate stock ownership to permit the consolidation or division of related corporate entities. Section 355 imposes a number of restrictive requirements to ensure that corporate earnings, which would normally be included in a shareholders tax return as regular income, cannot be included in a shareholder's tax return as capital gains by virtue of the distribution of stock in a divisive reorganization.

Since the Tax Reform Act of 1986 phases in the elimination of preferred capital gains tax rates, the strict standards of § 355 of the Internal Revenue Code are difficult to justify. In any event, bankruptcy reorganizations typically involve the dilution of equity rather than a reshuffling of equity, and therefore § 355 has little relevance to the taxation of bankruptcy reorganizations.

Section 356. Generally, in a tax-free reorganization a corporation does not recognize gain or loss on the receipt of boot (property other than stock or securities), if the corporation distributes the boot to its shareholders as part of the plan of reorganization. [FN136] Shareholders who obtain boot in a tax-free reorganization must recognize gain. [FN137] Shareholders cannot, however, recognize loss on the transaction.

Since creditors step into the shoes of shareholders in a "G" reorganization, applying tax principles strictly, creditors would logically be treated the same as shareholders and denied the business loss deduction to which creditors are otherwise entitled. However, this is not the case - trade creditors and short term lenders do obtain a loss deduction since their losses do not stem from the loss of worthless securities.

Bankruptcy Tax Policy

Background. The conflict between bankruptcy and tax policy is evident in the "G" reorganization provisions. For example, bankruptcy policy encourages the survival of businesses through new investment, mergers and acquisitions. Tax policy does not permit tax-free mergers and acquisitions where the original investment is liquidated. In violation of tax policy, bankruptcy reorganizations allow old tax attributes to attach to new equity, despite the disappearance of the old equity holders. The tax law requirement that continuity of interest be maintained contradicts the bankruptcy reality that shareholder interests are often extinguished.

Further, the cornerstone of the "G" reorganization rules is the notion that shareholders stand in the shoes of creditors. From a bankruptcy prospective, creditors of an insolvent corporation may have the same economic interests as the shareholders. However, the tax implications of being a shareholder are much different than the tax implications of being a creditor. The failure to reconcile ***81** the contradiction between a creditor's status as a

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creditor and a creditor's tax treatment as a shareholder makes the "G" reorganization option inherently ambiguous.

Tax Policy

Clarification of the Law. The "G" reorganization rules simplified the complex case law and statutes which previously crippled tax reorganizations in bankruptcy. The "G" reorganization rules, though not models of clarity, are intentionally simple in some important respects. For example, the relation back approach to identification of creditors who count as shareholders simply looks to the most senior creditors obtaining stock. To determine whether substantially all of the debtor's assets have been transferred as part of a "G" reorganization, the Internal Revenue Service looks only to the date that the debtor first contemplated tax reorganization. Unfortunately, simplicity in these contexts sometimes limits creative strategies that debtors in bankruptcy need to survive.

Equal Treatment In and Out Bankruptcy. The "G" reorganization rules apply to debtors in bankruptcy and to debtors in workout situations. Insolvent debtors in bankruptcy enjoy no tax advantage over insolvent debtors reorganizing outside of bankruptcy. However, solvent debtors in bankruptcy do enjoy an advantage over solvent debtors not in bankruptcy.

Fresh Start But No Head Start. The "G" reorganization rules give corporate debtors a fresh start by deeming creditors to be shareholders and thus permitting tax-free reorganizations in bankruptcy. A debtor corporation is entitled to non-recognition of gain and carryover of corporate tax attributes such as net operating losses. In the absence of bankruptcy a corporation would lose those benefits when shareholders' interests are terminated and worthless security deductions taken. Thus, debtors in bankruptcy enjoy a "head start."

Simplicity and Administerability. The Service has an unfair advantage over debtors because the Service is not bound by bankruptcy court orders addressing the tax consequences of a proposed plan of reorganization. [FN138]

Fairness and Equity. The fairness of the "G" reorganization rules depends on the extent to which one believes that economic policy should be effected by tax laws. [FN139] Having enacted the law, it is unfair to make the tax incentives pertaining to debtors in bankruptcy uncertain and unpredictable. A debtor in bankruptcy should be allowed to obtain an advance ruling from the bankruptcy court deciding whether the "G" reorganization rules have been satisfied.

Bankruptcy Policy

Fresh Start. The "G" reorganization rules give debtors in bankruptcy a fresh start by deeming creditors to be shareholders and thus permitting tax-free ***82** reorganizations. The debtor's fresh start is compromised to the extent the "G" reorganization rules are unclear, especially in the areas of continuity of interest, the relation back doctrine, and the measurement of substantially all of the debtor's assets under § 354 of the Internal Revenue Code.

Equality of Distribution Among Creditors. Equality of distribution is limited by the "G" reorganization rules to the extent that the relation back doctrine limits the mix of consideration that certain creditors can take. In bankruptcy reorganizations the debtor's various assets can be distributed to creditors on any **basis** on which the debtor and creditors agree. Stock is one "asset" that can be distributed. To ensure equality among creditors, all creditors should have the same right to take equity in satisfaction of claims. The relation back doctrine limits the right to take stock in a "G" reorganization because creditors receiving stock do not count toward satisfying continuity of interest unless all classes below those creditors have at least 50% of their claims satisfied by stock. There is no good reason either to (i) limit which creditors can be counted as taking stock, or (ii) require for continuity of interest that creditors have more than 50% of their claims satisfied by stock.

Rehabilitation Favored Over Liquidation. Obviously, "G" reorganizations further debtor rehabilitation. While

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stock for debt exchanges permit a debtor to generate capital from within, the "G" reorganization rules allow a debtor to recapitalize by combining with another entity. Rehabilitation is restricted to the extent that the Service suggests that § 354(b) of the Internal Revenue Code requires that at least one shareholder takes stock in exchange for stock, because cramdown under § 1129(b) of the Bankruptcy Code becomes problematic. In a "G" reorganization at cram down, the debtor cannot confirm a plan over the objection of a class of creditors if any creditor with less priority than the objecting class obtains property under the plan. Since shareholders generally have the lowest priority, no cram down confirmation could occur if a shareholder had to receive stock for a "G" reorganization to be effective.

Rehabilitation is further compromised by the requirement that a debtor dispose of substantially "all" of its assets to consummate a "G" reorganization, insofar as the Service measures substantially all of the debtor's assets from a point in time before the debtor has disposed of its non-performing assets.

Economy of Administration. Economic administration of bankruptcy cases is frustrated to the extent the debtor cannot predetermine the tax consequences of its proposed plan.

IMPACT OF BANKRUPTCY REORGANIZATION ON NOL'S

Historical Background

Generally, tax theory condemns transactions where the tax consequences alone create economic viability. Tax rules dating back to 1918 have discouraged ***83** buying and selling tax losses. Taxpayers, however, condemn a tax system that requires sharing of gain when a company makes money, but, "if it loses money, the government may, in effect, just walk away . . . . [I]t is an example of tax policy taking off on a conceptural flight of its own . . . . " [FN140] Taxpayers view net operating loss carryovers as an appropriate averaging device, and condemn the government view that "deems the averaging of tax benefits between tax years acceptable as a matter of tax policy, but the averaging of such benefits between taxpayers unacceptable." [FN141]

Over the years, provisions of the Internal Revenue Code have permitted very limited carryovers and carrybacks of net operating losses. [FN142] At one time, corporate reorganizations presented non-statutory possibilities for carryover of tax attributes, and the propriety of those carryovers reached the Supreme Court as early as 1934. In New Colonial Ice [FN143] the Court adopted an "entity" approach and held in the merger of a "loss" and a "gain" corporation that, if the gain corporation survived, it was not the same taxpayer that sustained the losses. Deductions of the old loss corporation's net operating loss were denied against current income of the surviving gain corporation.

Similarly, under the Internal Revenue Codes of 1938 and 1954 a successor corporation to a debtor corporation in bankruptcy was deemed a separate entity and therefore net operating losses could not be carried over. The rule came to be known as the "clean slate doctrine." [FN144] As a result of the entity theory and clean slate doctrine, form prevailed over substance as taxpayers soon learned that, if the loss corporation survived a merger in form, corporate attributes could be preserved. "Minnows swallowing whales" were fairly common during the period. [FN145]

The predecessor to § 269 of the Internal Revenue Code, [FN146] enacted in 1943, authorized the Internal Revenue Service to disallow any deduction, including net operating loss carryovers, if the "principal purpose" of corporate acquisition was the evasion of federal income tax. Section 269 authorizes the commissioner to disallow deductions, based on a subjective consideration of the purpose of an acquisition. The simplicity of § 269 is attractive. The courts usually ***84** allow the taxpayer the benefit of the doubt concerning the subjective purpose and intent of a transaction. [FN147]

In 1957, in Lisbon Shops v. Koehler, [FN148] the Supreme Court abandoned earlier tests, and (applying the 1954 Code) considered "continuity of business enterprise" to determine whether net operating losses carry over.

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Lisbon Shops involved sixteen commonly owned brother-sister corporations (which owned sixteen stores), that merged into one corporation. The surviving corporation attempted to offset the pre-merger losses of three of the stores against the post-merger income of all of the stores. The court denied the post-merger loss deduction because the post-merger income was not earned by "substantially the same business which incurred the losses." The Lisbon Shops rule was not repealed until the enactment of the Tax Reform Act of 1986. [FN149]

By regulation the Treasury further restricted net operating loss carry-overs in 1966. Specifically, the "consolidated returns change in ownership" regulations provide that, if a common parent of a consolidated return group experiences a larger than 50% change of stock ownership, pre-change net operating loss carryovers may only offset income earned by pre-change members of the consolidated return group. The single return limitation year regulations provide that, when an acquired corporation becomes a member of a consolidated return group, the acquired corporation's pre-acquisition net operating loss carryovers can offset only the acquired corporation's post-acquisition income. [FN150]

The Bankruptcy Tax Act of 1980, which included the special "G" reorganization rules for debtors in bankruptcy, made the general rules governing carryover of net operating losses from one year to another applicable to bankruptcy plans of reorganization. Those rules continue to apply to plans of reorganization in bankruptcy, provided the initial petition for bankruptcy was filed before August 14, 1986. [FN151] The 1980 rules disallowed the carryover of net operating losses as a deduction against corporate income in years following the realization of such income if (i) there is a 50% change in ownership of the corporation's stock by the debtor's ten largest shareholders, and (ii) the corporation's business is not carried on substantially the same following such change of ownership. In addition, the 1980 rules disallow or reduce the carryover net operating losses in the case of a tax reorganization if following the reorganization the ***85** shareholders of the loss corporation do not own 20% of the stock of the reorganized corporation.

Tax Reform Act of 1986

After many studies and many legislative efforts, the Tax Reform Act of 1986 introduced in § 382 the "neutrality principle" for net operating loss carryovers. The policy goal of the neutrality principle is to allow net operating losses to be freely transferable and usable after an acquisition to the extent that the net operating losses would likely have been usable to the loss corporation if no acquisition had occurred. [FN152]

The key to the neutrality principle is estimating the value of net operating losses in the hands of the loss corporation, and carrying those losses over to the hands of the surviving corporation without enhancement or diminution. [FN153] The neutrality principle distinguishes incidental carryovers from carryovers so large as to be the main object of a corporate acquisition.

Section 382 has three distinctive features. First, no differentiation is made between tax-free and taxable reorganizations. Second, the trigger for reducing carryover is an objective measurement of 50% change in stock ownership. Third, tax "neutrality" is achieved by limiting net operating loss carryovers to the amount of money that would have been earned had the value of all of the stock of the old loss corporation been invested in tax exempt bonds.

In other words, prior to an ownership change, Corporation X can use net operating loss carryovers only to the extent that it has income against which the loss carryovers can be deducted. The amount of income is the product of Corporation X's operations. Following an ownership change, the Internal Revenue Code deems the amount of income Corporation X earns to be the amount of money that the value of all of Corporation X's stock would earn if that value was invested in tax exempt bonds. Thus, following an ownership change, Corporation X can use its pre-change net operating loss carryovers as a deduction against post-change income only up to the amount of income that the service deems to represent interest on the pre-change value of Corporation X.

Ownership Change

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The limitation on net operating loss carryovers is triggered by an ownership ***86** change. An ownership change occurs if within a three-year testing period, 50% of a corporation's stock is transferred to shareholders who hold at least 5% of the corporation's stock. [FN154] The code aggregates less than five-percent shareholders into a single five-percent shareholder. [FN155]

An ownership change may be created by a taxable purchase of stock, a disposition of stock, a conversion of debt to stock, a contribution of capital to the loss corporation, a decrease in the outstanding stock of the loss corporation, or an issuance of stock by the loss corporation. [FN156] A "G" reorganization is described in § 382 as an equity structure shift, [FN157] which would trigger an ownership change. [FN158]

Thus, in order to determine whether an ownership change will occur as a consequence of a distribution of stock, it is necessary to identify who the debtor's 5% shareholders are, and to measure how much their ownership has increased. If 5% shareholders' ownership increased by 50%, an ownership change will have occurred, and net operating losses will be reduced. Five percent shareholders include all shareholders who at any time during the three-year period prior to the testing date held 5% of the debtor's stock, warrants, or options. The shareholders who never held more than 5% of the debtor's stock are deemed to aggregate into a single 5% shareholder.

For debtors in bankruptcy, all increases in ownership within three years of confirmation (including changes caused by confirmation) must be aggregated to see whether the increases exceed 50 percent. Increases are based on the value of shares. Unfortunately, it is impossible to predict prior to confirmation the percentage increase unless trading of shares is halted.

***87** Ownership Change and Preferred Stock. In determining whether an ownership change has occurred, "stock" does not include preferred stock as defined in § 1504(a)(4) of the Internal Revenue Code. [FN159] Preferred stock under § 1504(a)(4) does not have voting rights. This definition works as a hindrance to debtors in bankruptcy because § 1123 of the Bankruptcy Code prohibits distribution of nonvoting equity securities following a debtor's bankruptcy plan of reorganization. Therefore, a debtor not in bankruptcy could raise capital without triggering an ownership change by distributing preferred stock, but a debtor in bankruptcy cannot at confirmation. [FN160]

Effect of Ownership Change

For any taxable year ending after the date of an ownership change, the amount of a loss corporation's taxable income that can be offset by pre-change losses cannot exceed the "§ 382 limitation" for that year. [FN161] This limitation is determined by multiplying the value of the loss corporation immediately before the ownership change by the long-term tax exempt rate. [FN162] The long-term tax exempt rate is published by the Treasury monthly. The value of the loss corporation is the fair market value of the loss corporation's stock immediately before the ownership change. [FN163] For example, if the value of a loss corporation's stock immediately before the ownership change is $1,000,000, and the tax exempt rate is 10%, a corporation can only take $100,000 of carryover net operating loss deductions per year following the ownership change.

The value of the stock of a loss corporation in bankruptcy is determined immediately after rather than before the ownership change in either a stock-for-debt exchange or a "G" reorganization. [FN164] Because the value of the loss corporation ***88** stock is determined after the ownership change, arguably, the value of the loss corporation can include fresh capital contributed as part of a stock-for-debt exchange or as part of a "G" reorganization, which thereby increases the annual limitation. The Internal Revenue Service would probably look unfavorably on such a result as an unfair advantage to debtors in bankruptcy. Generally, contributions to capital made in the two years before an ownership change are treated as part of the overall plan and disallowed. [FN165] In short, Congress has enacted measures to stop taxpayers from infusing a corporation with capital shortly before an ownership change in order to increase the yearly net operating loss carryover deduction the corporation will enjoy after an ownership change. It is unlikely, therefore, that the Service would look favorably upon debtors in bankruptcy seizing on the literal language of the statute to avoid the restrictions on eleventh hour infusions of capital.

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The Continuity of Business Enterprise Test

The Tax Reform Act of 1986 introduced the "continuity of business enterprise" test to replace the old "change in business" test. The continuity of business enterprise test presumably follows the standards set forth for corporate reorganizations under § 368. [FN166] Thus, the surviving corporation must continue at least one "significant" line of the old corporation's "historic business," or use in any business a "significant" portion of the old corporation's business assets. [FN167]

In light of the neutrality principle that tax benefits should neither encourage nor discourage an acquisition, [FN168] the requirement of a continuity of business enterprise test is puzzling. The neutrality principle, which purportedly underlies the 1986 Tax Act net operating loss carryover rules, was supposed to simplify the rules and treat all changes of ownership on a single objective **basis.** As noted above, the net operating losses of a pre-ownership change corporation can be carried over and set off against income of the post-ownership change corporation to the extent that the pre-change corporation could have earned income if it had invested its value in tax exempt bonds.

Since Congress has set forth an objective measure of income that can be set off by net operating loss carryovers, there is no reason to require that the post-change business engage in the same business as the pre-change business. Thus, the continuity of business enterprise test denies attribute utilization to the surviving corporation in some circumstances, and makes those attributes less valuable to the surviving corporation than they were to the old loss corporation. Therefore, the continuity of business enterprise restrictions of the Tax ***89** Reform Act of 1986 violate the neutrality principle by imposing a tax disincentive upon certain corporation reorganizations. [FN169]

Similarly, § 382(1)(4)(A) [FN170] restricts net operating loss carryovers where one-third or more of the fair market value of a loss corporation's assets consist in non-business assets. In those instances, where the loss corporation undergoes an ownership change, the value of the loss corporation must be reduced by the excess of the value of non-business assets over the portion of the corporation's indebtedness attributable to such assets. Because the availability of net operating loss carryovers is the product of the value of the loss corporation's stock multiplied by the tax exempt bond rate, reduction of the value of the loss corporation will translate into a reduction of net operating loss carryovers. Once again, if the tax benefit of net operating loss carryovers is deemed by statute to be the "neutral" economic benefit, tax policy is retarded by reducing that tax benefit for particular taxpayers based upon the value of non-business assets owned by those taxpayers.

Built-In Losses and Built-In Gains

"Built-in loss" refers to any tax loss that would be recognized for tax purposes upon the sale of assets following an ownership change. "Built-in gain" refers to any tax gain that would be recognized for tax purposes upon the sale of assets following an ownership change.

For example, if a debtor owns land purchased for $100, and on the date the debtor experiences an ownership change, the land is worth only $50, the debtor has a built-in loss of $50. By the same token, if a debtor owns land purchased for $50, and on the date the debtor experiences an ownership the land is worth $100, the debtor has a built-in gain of $50.

Section 382 treats all built-in loss recognized during the five years after an ownership change as pre-change loss subject to the § 382 limitations described above. By the same token, built-in gains increase the § 382 limitation for the taxable year by the amount of the recognized built-in gain. [FN171] If the aggregate built-in gain or loss does not exceed twenty-five percent of the fair market value of the pre-change corporation's assets, however, the built-in gain or loss is deemed to be zero. [FN172] The Omnibus Budget Reconciliation Act of 1987 added § 384 to the Internal Revenue Code to preclude the use of net operating carryovers to offset built-in gains of an acquired corporation.

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*90 Special Bankruptcy Rules

Before the enactment of the Tax Reform Act of 1986, net operating losses carried over following an ownership change of a debtor in bankruptcy provided (a) the former shareholders (and creditors in the case of a "G" reorganization) received at least 20% of the stock of the surviving corporation; [FN173] and (b) the surviving corporation did not change its business within 2 years. [FN174] Both old and new § 382 deemed creditors to be shareholders for purposes of determining whether an ownership change has occurred. Thus, § 382 incorporates the continuity of interest principle that creditors succeed shareholders of debtors in bankruptcy. [FN175]

Under new § 382, if the pre-ownership-change creditors and shareholders of a debtor in bankruptcy own at least 50% of the value and voting power of the stock of the loss corporation after the ownership change, at the election of the debtor, neither the annual limitation on the amount of income that can be sheltered by the carryover of built-in losses, nor the continuity of business enterprise requirements apply; provided the ownership change is part of a court-approved plan of reorganization. [FN176] For these purposes, stock received by a creditor in exchange for debt counts towards the 50% threshold only if the creditor held the debt for at least 18 months before the filing of the debtor's bankruptcy, or if the debt arose in the ordinary course of the loss corporation's trade or business, and was held by the same creditor to whom the debt was initially owed. [FN177]

The restriction on transfer of creditor claims is intended to subject creditors to the same rules as shareholders. Thus, if 50% of the "old and cold" creditors sell their claims, full reduction of net operating losses could be the consequence. As stated by the Treasury:

> In our view, only the historic creditors are fairly assumed to be parties who economically suffered the loss and who are thus analogous to loss corporation shareholders. [FN178]

*91 The Treasury's statement makes no sense. The fact that an historic creditor transfers its claim tells us nothing about whether it has suffered an economic loss and therefore stepped into the shoes of shareholders. An historic creditor's desire to liquidate its claim quickly should not, therefore, inhibit the reorganization of debtors in bankruptcy by causing a restriction on the use of net operating loss carryovers. Worse, the tax penalty is retroactive and penalizes trades of claims made when there was little reason to anticipate the impact upon net operating losses. [FN179] The tax restrictions on trading in claims has little justification and should be repealed.

The "toll charge" for the bankruptcy exception is a reduction of the net operating losses of the old loss corporation equal to one-half of the amount of cancellation of indebtedness income hypothetically realized in stock for debt exchanges. [FN180] Effectively, net operating loss carryovers are reduced by 50% of the difference between the amount of debt canceled by creditors and the value of the shares they receive in the reorganized debtor.

For example, if a debtor with $100 of debt and $100 of net operating losses confirms a bankruptcy plan of reorganization which provides for payment to creditors of $.50 per dollar of debt, no reduction of net operating losses will result, and $100 of net operating losses will survive. If, on the other hand, a debtor with $100 of debt and $100 of net operating losses confirms a reorganization plan which provides for payment to creditors with shares of the debtor's stock worth $.50 per dollar of debt, then net operating losses will be reduced by 50% of the difference between the amount of debt canceled ($100) and the value of the shares creditors receive ($50). Thus $75 of net operating losses will survive. Net operating losses are also reduced by the interest on any debt that was paid or accrued during the three-year period preceding the bankruptcy ownership change, if that interest was converted into stock in the reorganization. [FN181]

Finally, if a loss corporation taking advantage of the bankruptcy exception changes ownership within two years, net operating losses after that second ownership change are eliminated. [FN182] The two-year limitation rule is intended to prevent debtors from making large capital contributions during the measuring period to obtain large net operating loss carryovers that might enable shareholders to sell the stock immediately at a higher price. The

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rule has been criticized, because in bankruptcy cases the price paid for the stock in a second change of ownership is typically attributable to earnings and the prospect of future earnings, not "stuffing" of capital into the business. [FN183] Apparently the ***92** Treasury shares this concern, [FN184] and therefore taxpayers might successfully seek relaxation of this all-or-nothing limitation.

In order to avoid inadvertently triggering an ownership change, a number of chapter 11 plans confirmed under the new net operating loss carryover rules contain provisions limiting the transfer of stock issued under the plan for two years. Such plans provide for an initial distribution of stock to a trust, followed by ultimate distribution to the various classes of claimants from the trust over a period of two years. [FN185] The initial distribution of stock to the trust causes an ownership change. By delaying ultimate distributions to claimants no owner-ship change within two years will occur as a consequence of claimants transferring shares. Although no hard data is available, such jumping through hoops can only impede creditor's acceptance of plans, and detract from the clear congressional mandate to provide debtors in bankruptcy relief from the new limitations on net operating loss carryovers.

Recently Proposed Reg. 1.269-3(d) adds yet another obstacle to the use of the bankruptcy exception: the debtor must prove that ownership change was not made to avoid tax in any case in which the new active trade or business requirement is not met. As noted above, § 269 of the Internal Revenue Code authorizes the Internal Revenue Service to deny the tax benefits flowing from a tax reorganization where the principal purpose of the transaction is to evade tax. The proposed regulations state that, absent evidence to the contrary, where the bankruptcy exception to § 382 applies, the principal purpose of the reorganization is deemed to be evasion of federal taxes unless the corporation carries on more than an insignificant amount of an active trade or business during and subsequent to the bankruptcy case. Open issues include the definition of what constitutes an active trade or business, and, more importantly, whether the proposed regulations will survive the anticipated avalanche of negative comment letters.

Significantly, the proposed regulation also seeks to undermine the power of the bankruptcy courts to rule under Bankruptcy Code § 1129(d), which provides that upon the request of a party in interest (such as the Service) the bankruptcy court must deny confirmation of a plan, the principal purpose of which is to avoid taxes. The proposed regulations provide that any bankruptcy court determination under § 1129(d) of the Bankruptcy Code will not control a subsequent challenge by the Service under § 269 of the Internal Revenue Code.

The proposed regulations are yet another example of the uncertainty created for taxpayers by the conflicts between the Internal Revenue Code and the Bankruptcy Code.

*93 THE INTERPLAY OF NET OPERATING LOSS CARRYOVERS AND THE STOCK FOR DEBT EXCEPTION TO CANCELLATION OF INDEBTEDNESS INCOME

Assume that Corporation X is considering a plan of reorganization that will distribute (i) small cash payments plus 90% of "new" X stock to creditors, and (ii) 10% of new X stock to shareholders. An ownership change will be triggered by virtue of a change of ownership of more than 50% of X stock, and X must decide whether to exercise the stock for debt exception to cancellation of indebtedness income.

On the one hand, because the confirmation of the plan triggers an ownership change, the stock for debt exception causes a $.50 reduction in net operating losses for each dollar of debt forgiven. Thus, if $10 of debt is satisfied with $5 of stock, net operating losses must be reduced by $2.50.

On the other hand, failure to exercise the stock for debt exception will cause no reduction of net operating losses. Instead, the **basis** of X's assets will be reduced one dollar for each dollar of debt forgiven, and, when A has no **basis** in its assets, then net operating loss carryovers will be reduced by one dollar for each dollar of debt discharged. Thus, if X's **basis** in its assets is $10, and X does not exercise the stock for debt exception, X's **basis** will be reduced by the value of the stock ($5), and X will be left with a $5 **basis** in its assets.

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At the very least, the following factors must be considered to determine which option is better:

1. X's **basis** in its assets. If X has a very low **basis** in its assets, the failure to exercise the stock for debt exception means net operating loss suicide, because after that **basis** has been reduced to zero, net operating loss carryovers will be reduced dollar for dollar of debt forgiveness;

2. X's intentions regarding sale of assets. If X intends to sell its assets soon after confirmation, use of the stock for debt exception is probably better.

Example: Assume X has $10 of claims, $10 in net operating loss carryovers and $10 **basis** in its assets. Assume X were to exchange stock valued at $5 for its claims. Such an exchange would cause a $.50 on the dollar reduction in net operating loss carryovers. The $10 of loss carryovers must be reduced by one-half of the $5 of debt discharged, leaving $7.50 in net operating loss carryovers. If subsequently, X were to sell its assets for $17.50, X would realize a $7.50 gain, ($17.50 minus $10 **basis)** and that gain would be offset by the $7.50 net operating loss. No gain would be recognized. If X failed to exercise the stock for debt exception (or if X exchanged $5 in cash for the claims), X's **basis** in its assets would drop dollar for dollar for the $5 of debt discharged, from $10 to $5, and the net operating loss would remain at $10. When X sold its assets for $17.50, X would realize $12.50 gain ($17.50 minus $5), only $10 of which could be offset by its net operating loss. Thus, X would recognize $2.50 gain.

***94** 3. The Likelihood of large earnings shortly after confirmation. If X can anticipate large earnings, the waiver of the stock for debt exception is probably better.

Example: Assume again $10 of claims, $10 net operating loss and a $10 **basis** in assets. If X exchanged $5 of stock for $10 of claims and did not elect the stock for debt exception (or if X exchanged $5 cash) X will reduce its **basis** in its assets dollar for dollar of debt discharged from $10 to $5, and leave the $10 net operating loss carryover undisturbed. If the next year X earns $10, the $10 net operating loss will offset the gain. Assuming X exercised the stock for debt exception, however, if $5 of stock was exchanged for $10 of claims, net operating loss carryovers would be reduced by $.50 on the dollar of the $5 of debt discharged, from $10 to $7.50. If the next year's earnings were $10, X could only offset $7.50 with its net operating loss and would recognize $2.50 in income.

Bankruptcy Tax Policy

Background

The treatment of net operating loss carryovers in bankruptcy again illustrates the conflict between bankruptcy and tax policy. Under § 541(c)(1) of the Bankruptcy Code, all property interests of the debtor become property of the debtor's bankruptcy estate, "notwithstanding any provision in an agreement, transfer instrument, or applicable non-bankruptcy law." Bankruptcy lawyers, accustomed to defining property of the estate very broadly, presume that net operating loss carryovers are included. [FN186]

As a matter of tax policy, however, transferability of net operating loss carryovers is not tenable, because net operating losses carry much more value for solvent taxpayers than they do for insolvent taxpayers. The following analogy to a vacation-exchange illustrates the difference in value:

> Suppose you are an employer who grants all your employees vacations of one month each year. Under your vacation rules, at the end of each year each employee must take her vacation or receive one month's pay in lieu of her vacation. Alternatively, if the employee chooses, she can transfer her vacation rights to another employee, who can then either use the vacation or turn in the vacation right to her employer in exchange for pay equal to one month of her pay. Would any enlightened employer adopting a vacation program permit an employee earning $12,000 a year to convey her $1,000 vacation right to a fellow employee earning $60,000 a

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year, who promptly remits the vacation right and receives $5,000 cash? As improbable as that sounds, it is the Internal Revenue Code's present vacation - tax vacation - policy.

***95** Corporate taxpayers possessing NOL tax vacation entitlements, to them worth $1,000 or zero, may transfer those entitlements to other corporate taxpayers who cash them in as deductions on their Forms 1120, receiving cash tax savings of $5,000, $50,000, or millions of dollars. [FN187]

In summary, tax policy is violated by relaxing the general restrictions on net operating loss carryovers while bankruptcy policy is violated by imposing any restrictions on net operating loss carryovers.

Although the special bankruptcy rules appear to offer advantages to debtors in bankruptcy, upon closer examination the advantages diminish. In the event of an ownership change, net operating loss carryovers are reduced by one-half of the amount of the debt discharged in exchange for stock, and the cost imposed upon debtors in bankruptcy to qualify for special net operating loss carryover treatment may outweigh the benefits.

For example, if within two years of bankruptcy the debtor undergoes a second ownership change, the special bankruptcy treatment is retroactively revoked. A public company with little control over the exchange of its stock does not know at the time of reorganization whether it will ultimately enjoy the benefits of the special bankruptcy treatment. Similarly, the special bankruptcy treatment does not apply if the debtor emerges from bankruptcy with shareholders and former creditors holding less than 50% of the debtor's stock. For these purposes, stock obtained through claims transfers does not count towards the 50% threshold. Thus, trading in claims, an increasingly popular Wall Street investment strategy, could inhibit the debtor's ability to carry over net operating losses, notwithstanding that trading is beyond the control of debtors in bankruptcy.

Finally, corporations not in bankruptcy can issue non-voting preferred stock without triggering an ownership change. Debtors in bankruptcy, however, are prohibited by the Bankruptcy Code from issuing non-voting preferred stock.

The extraordinary measures that debtors may have to take to preserve the special bankruptcy treatment of net operating loss carryovers (for example, prohibiting trades of stock for two years following bankruptcy) make it problematic whether the special bankruptcy tax treatment offers any advantage over the regular treatment of net operating loss carryovers.

Tax Policy

Clarification of the Law. The tax treatment of net operating loss carryovers has always been unclear, and the Tax Reform Act of 1986 only compounded the confusion.

***96** Equal Treatment In and Out of Bankruptcy. The net operating loss provisions for insolvent debtors apply only to corporations under the formal jurisdiction of a bankruptcy court, and expressly exclude informal workouts (although the conference report directs the Treasury to study the informal workout situation). [FN188] Exclusion of informal workouts under the current law could encourage filing bankruptcy. [FN189]

The bankruptcy exception gives preferential treatment to solvent debtors in bankruptcy over insolvent debtors not in bankruptcy. Granting to solvent taxpayers benefits not enjoyed by insolvent taxpayers is especially offensive to tax policy:

> The Treasury's argument against an informal workout provision was "to ensure that [the bankruptcy exceptions] cannot be used by solvent corporations to avoid application of the general limitations." [FN190]

Fresh Start But No Head Start. Carryover of net operating losses in bankruptcy despite loss of shareholder equity allows debtors to keep built-in tax benefits while simultaneously reducing pre-bankruptcy tax liabilities.

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Therefore, in principle debtors in bankruptcy obtain a head start.

Simplicity and Administrability. Once again, simplicity and administrability are compromised because the debtor can obtain no advance ruling regarding how the Service will treat the debtor's plan. Even if advance rulings were allowed, the requirement that no ownership change occur for two years following bankruptcy complicates the administration of the tax law for no apparent tax advantage.

Fairness and Equity. Restricting the carryover of net operating losses for distressed businesses is an unhealthy use of tax law to implement economic policy. The fairness of carryover of net operating losses for distressed businesses is easily articulated if divorced from its tax implications.

Bankruptcy Policy

Fresh Start for Debtors. The net operating loss carryover rules promote the debtor's fresh start by allowing the debtor to offset future income against past losses.

Fair and Equitable Treatment of Creditors. The net operating loss carryover rules do not directly implicate the treatment of creditors.

Debtor Rehabilitation Favored Over Liquidation. The purpose of the special bankruptcy exception is to promote rehabilitation over liquidation. That ***97** result is accomplished by easing the debtor's future tax liabilities to make more money available to fund a plan of reorganization. That result is frustrated by the limitations imposed upon net operating loss carryovers under the 1986 Tax Act, including:

(i) retroactive revocation of the bankruptcy exception in the event of an ownership change within two years of bankruptcy;

(ii) revocation of the bankruptcy exception if more than 50% of the claims of creditors to be paid with stock under a plan of reorganization are transferred claims;

(iii) the restrictions upon issuance of preferred stock by debtors in bankruptcy, where such issuance would otherwise avoid any limitation on net operating loss carryovers.

Economy of Administration. That the net operating loss carryover rules are so complex, arbitrary, and unpredictable makes tax planning one of the most expensive and time-consuming elements of designing a plan of reorganization.

ADVANCE DETERMINATION OF TAX CONSEQUENCES OF BANKRUPTCY REORGANIZATIONS

The Present Law

The immediate and future tax burdens imposed by a proposed plan of bankruptcy reorganization may be critical to confirmation. Tax burdens are very important to valuation of the debtor, which bears directly on whether the plan is in the best interest of creditors, is "fair and equitable" to creditors [FN191] and whether reorganization is likely to be followed by liquidation or further financial reorganization. [FN192] The bankruptcy court must find that the plan is proposed in good faith and not by any means forbidden by law, including the tax law. [FN193] Upon request of "any governmental unit," the bankruptcy court must make an additional finding that the principal purpose of the plan is not tax avoidance. [FN194] Notwithstanding a bankruptcy court's findings for the debtor on all of these issues and confirmation of a plan, the Internal Revenue Service can then deny the expected tax benefits and relitigate the same issues after confirmation in non-bankruptcy forums.

Private letter rulings offer little useful relief. If the Service declines to issue a ruling, if a ruling is delayed, or if

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 281

a debtor disagrees with a ruling, the debtor has no redress and the plan of reorganization could be jeopardized.

Debtors considering a preconfirmation judicial determination of tax issues face two impediments: (1) the Internal Revenue Code prohibits suits "for the ***98** purpose of restraining the assessment of collection of any tax," [FN195] and (2) the Declaratory Judgment Act enforces the Internal Revenue Code restriction by excluding issues "with respect to Federal taxes." [FN196]

These problems are more than theoretical. In In re Inland Gas Corp. [FN197] the district court refused to confirm the debtor's plan of liquidation because the risk created by the Service's adverse private letter ruling pertaining to the imposition of gain under § 337 of the Internal Revenue Code rendered the plan not "feasible" and not "equitable." The circuit court affirmed, and held that the Declaratory Judgment Act precluded the debtor from seeking judicial review of the adverse letter ruling. In In re Wingree Co., [FN198] the Service refused to issue a letter ruling. The circuit court held under the Declaratory Judgment Act that the district court had no authority to order the Service to inspect the debtor's books and determine the nature and extent of any available loss carryovers.

Bankruptcy courts can make binding advance determinations of the tax consequences of reorganizations only with respect to state and local taxes. Under § 1146(d) of the Bankruptcy Code the bankruptcy court may authorize the proponent of a reorganization plan to request a state or local taxing authority to declare the tax effects of the plan. In the event of a controversy, the court may rule on those tax effects after the earlier of the date the taxing authority responds or 270 days after the request. [FN199] The bankruptcy court's ruling under § 1146 is limited however to "questions of law." [FN200] Thus, the bankruptcy court can declare whether a reorganization qualifies for tax-free status under state and local law, but the bankruptcy court cannot fix the dollar amount of any tax attributes that survive the reorganization.

Legislative History

Before enactment of the Bankruptcy Reform Act of 1978, both the House and Senate considered including in § 1146(d) bankruptcy court authority to determine federal as well as state and local tax consequences of plans of reorganization. Only the provision for state and local tax consequences survived.

Initially, the Service was "in favor of remedial legislation in this area," if it was given nine months from the time of a request to make a response. [FN201] Upon inclusion of the 270 day provision in § 1146 of the Bankruptcy Code, the Service ***99** "did not oppose" the provision, provided additional funds would be appropriated to carry the anticipated "increased administrative burdens." [FN202] The provision for advance determination of federal tax consequences was subsequently stricken from the House version of the Bankruptcy Reform Act and inserted into the proposed Bankruptcy Tax Act without a hearing, as a result of a "jurisdictional conflict" between the House Ways and Means Committee and the House Judiciary Committee. [FN203] (The provision for advance determination of state and local taxes was not stricken and was ultimately passed.)

Subsequently, the Senate Finance Committee considered whether to strike the provision for advance rulings on federal tax effects from the Senate version of the Bankruptcy Reform Act. At the hearing, Treasury argued that bankruptcy courts should not be permitted to make advance rulings because of the "serious administrative problems" the IRS would encounter if debtors submitted numerous alternative proposed plans for a single reorganization. [FN204] The American Bar Association, in opposition, argued that bankruptcy judges should be permitted to make advance federal tax rulings because uncertainty over tax consequences would adversely affect the structuring of plans of reorganization:

> Should the Service take an adverse position, its view would have undue finality since proponents of a plan might not want to risk subsequent tax litigation even where they believe their provision properly expresses the applicable law. In this situation, declaratory relief seems appropriate. [FN205]

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Ultimately the Senate Finance Committee deleted from the Bankruptcy Reform Act the provision permitting the advance determination of tax consequences of bankruptcy reorganizations for reasons not foreseen by Treasury or the ABA:

> The committee believes that it is unfair to permit the bankruptcy court to issue a declaratory judgment, in effect, on tax matters for bankruptcy. [FN206]

That the tax law is so vague and confusing that the Senate committee considered it an "unfair" advantage for debtors in bankruptcy to be able to request bankruptcy court findings on tax matters is a sad commentary on congressional ***100** effort in this area. Congress should not perpetuate the incomprehensibility of bankruptcy tax laws by disabling the means for giving the laws meaning. In light of the strong policies favoring debtors in bankruptcy in the areas of **discharge** of **indebtedness,** reorganization and carryover of net operation losses, it is surprising that the marginal advantage of a declaratory judgment on tax questions in bankruptcy was enough to kill the proposal.

The advance determination provision was nominally revisited during the House consideration of the proposed Bankruptcy Tax Act of 1980, but the provision quickly disappeared from early drafts of the Act with no explanation. [FN207]

Bankruptcy Tax Policy

Background

Presently, the Declaratory Judgment Act and the Internal Revenue Code prohibit declaratory judgments with regard to federal taxes. This bar on tax determinations has been relaxed with respect to tax exempt organizations, [FN208] qualification of retirement plans [FN209] and interest on municipal bonds. [FN210] Advance determination for bankruptcy plans of reorganization is appropriate.

Tax Policy

Clarification of the Law. Given (i) the conflict between tax policy and bankruptcy policy in the areas of **discharge** of **indebtedness** income, "G" reorganizations, and carryover of net operating losses, (ii) the history of an evershifting balance between the two, and (iii) the imperfect fit of bankruptcy law and tax law, the tax law is improved to the extent the bankruptcy court can introduce clarity in particular cases.

Equal Treatment in and out of Bankruptcy. Notwithstanding the 1977 Senate Finance Committee conclusion that advance determination of tax issues would allow debtors in bankruptcy an unfair advantage, the advantage would not permit debtors in bankruptcy to pay less tax. Further, any such advantage is mitigated by the need for debtors in bankruptcy to obtain court approval for the transaction that gives rise to the advance determination. As demonstrated by Inland Gas Corp. and Wingreen, a debtor in bankruptcy may not be able to obtain bankruptcy court approval of a reorganization without an advance determination of tax consequences.

Fresh Start but no Head Start. The debtor's fresh start is hindered by the debtor's inability to determine the tax consequences of a plan of reorganization. Since the debtor would pay no less tax in or out of bankruptcy in most cases, no "head start" would result from procedural reform.

***101** Fairness and Equity. The administrative burdens upon the Service must be weighed against the lost benefits of reorganizations that fail or are frustrated by the ambiguity of tax law. The balance easily favors procedural reform.

Bankruptcy Policy

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Fresh Start. Certainty of tax consequences will enable debtors to utilize more effectively the tax advantages that Congress has bestowed upon insolvent corporations. Plans of reorganization will not be frustrated by the inability of the bankruptcy court to determine tax advantages as in Inland Gas Corp. and Wingreen.

Fair and Equitable Distribution Among Creditors. Given the present uncertain state of bankruptcy tax law, reorganization plans may require contingencies such as "givebacks" by creditors in the event of post-confirmation denial of tax benefits. To the extent that tax consequences are certain, contingency givebacks will be unnecessary and the parties can more effectively ensure a fair and equitable distribution among creditors.

Rehabilitation Favored over Liquidation. Certainty of tax burdens favors rehabilitation by establishing the conditions for confirmation of a plan. The court can value the debtor to ensure that a proposed plan is in the best interests of creditors and is fair and equitable. The court can also decide whether a plan complies with tax law. In addition, upon request by the taxing authority, the court can decide whether a plan is proposed for the purpose of tax avoidance. Further, certainty of tax benefits allows debtors to make a more convincing proposal to creditors for reorganization, and allows creditors to make a more informed decision whether to support a proposed plan.

Economy of Administration. If the bankruptcy court's decision is final, judicial economy is promoted by eliminating subsequent tax court relitigation. The debtor's administrative burden already includes consideration of tax consequences. To the extent a measure of certainty is realized, the time and expense devoted to tax matters should be reduced, both pre- and post-confirmation.

CONCLUSIONS

Tax policy and bankruptcy policy conflict because the bankruptcy policy favoring rehabilitation of troubled businesses is often effected by Congress through tax advantages to debtors in bankruptcy. The Treasury argues for payment of taxes regardless of hardship, and opposes in principle tax advantages for financially troubled taxpayers. This conflict creates ambiguity in bankruptcy tax law because (i) tax advantages to debtors in bankruptcy change frequently as the political will of Congress changes, and (ii) the implementation of those tax advantages often involves an imperfect juxtaposition of tax law principles and bankruptcy policies.

In the area of cancellation of indebtedness income, the insolvency exception has shifted in emphasis in recent years from reduction of **basis** upon debt ***102** forgiveness to virtually no reduction of **basis** and back again to reduction of **basis.** Under the most recent changes, reduction of net operating losses is a mandatory consequence of stock for debt exchanges if more than 50% of corporate stock is transferred. Uncertainty in this area presently includes the following issues:

(i) the treatment of solvent corporations in bankruptcy.

(ii) the consequences of a mix of consideration in a stock for debt exchange;

(iii) the application of the "de minimis" and "proportionality" limitations on stock for debt exchanges;

(iv) the timing of stock for debt exchanges; and

(v) the tax effect of a debt security for debt security exchange.

In the area of tax-free reorganizations in bankruptcy, the "G" reorganization provisions cleared away years of confusing case law, but new issues have emerged largely because tax law does not fully acount for the consequences of deeming a creditor to be a shareholder. Specific issues include:

(i) the identification of creditors to be treated as shareholders;

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(ii) cram down in a "G" reorganization; and

(iii) whether substantially all of the debtor's assets are transferred in a reorganization.

With respect to carryover of net operating losses, the law has shifted many times. Most recently the Tax Reform Act of 1986 sharply curtailed carryover and applied new criteria. Developing issues include:

(i) the effect of trading in claims by creditors;

(ii) the effect of a subsequent ownership change within two years of bankruptcy;

(iii) the effect of "single return limitation year" and "consolidated returns change in ownership" regulations;

(iv) the effect of issuance of non-voting preferred stock under the Bankruptcy Code;

(v) the effect of a fresh contribution of capital post-petition but pre-confirmation; and

(vi) the effect of worthless security deductions by fifty percent of former shareholders.

The uncertainty created by bankruptcy tax law is compounded by the inability of the debtor to obtain a binding advance determination of the tax consequences of reorganization. Section 1146 of the Bankruptcy Code should be amended to permit the bankruptcy courts to make advance determinations.

Advance determination of tax consequence will further the bankruptcy policies of (i) fresh start for debtors; (ii) equality of distribution among creditors; (iii) economy of administration, and most importantly (iv) favoring rehabilitation over liquidation. Tax policy would not be impeded, and may in fact be promoted, especially in the areas of (i) clarification of the law; and (ii) fairness and equity.

FNa1. Backenroth & Grossman, New York, New York. The author gratefully acknowledges the contributions of The Honorable Keith M. Lundin, United States Bankruptcy Judge for the Middle District of Tennessee, in preparing this article for publication.

FN1. 292 U.S. 234, 244 (1934) (quoting Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554-55 (1915)).

FN2. Report of the Commission on the Bankruptcy Laws of the United States, H.R. DOC. NO. 137, 93d Cong., 1st Sess. at I-75 (1973). H.R. REP. NO. 687, 89th Cong., 1st Sess. (1965); S. REP. NO. 1158, 89th Cong., 2d Sess. (1966), reprinted in 1966 U.S.C.C.A.N. 2468; Gochenour v. George & Francis Ball Found., 35 F. Supp. 508, 518 (S.D. Ind.), aff'd., 117 F.2d 259 (7th Cir. 1940), cert. denied, 313 U.S. 566 (1941).

FN3. 11 U.S.C.A. § 1129 (West 1979 & Supp. 1991).

FN4. H.R. REP. NO. 595, 95th Cong., 1st Sess. 220 (1977), reprinted in 1978 U.S.C.C.A.N. 6179-80.

FN5. 465 U.S. 513, 528 (1984).

FN6. 11 U.S.C.A. § 362 (West 1979 & Supp. 1991). All references to the "Bankruptcy Code" are to title 11 of the United States Code, enacted as part of Pub. L. No. 95-598, 95 Stat. 2549.

FN7. See 11 U.S.C.A. § 503(6)(1)(A) (West 1979 & Supp. 1991).

FN8. Otte v. United States, 419 U.S. 43, 53 (1974).

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FN9. Changes in Bankruptcy Tax Law: Hearing on H.R. 9973 Before the House Comm. on Ways and Means. 95th Cong., 2d Sess. 64 (1978) [hereinafter House Hearing, February 22, 1978] (testimony of Assistant Sec. of the Treas. Daniel I. Halperin).

FN10. House Hearing, February 22, 1978, supra note 9, at 74, 87 (testimony of M. Carr Ferguson).

FN11. Miscellaneous Tax Bills VII, Hearing on S. 2484, S. 2486, S. 2500, S. 2503, S. 2548, H.R. 5043, May 30, 1980, before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance, 96th Cong., 2d Sess. 413 (1980) (testimony of Robert A. Bergquist) [hereinafter Senate Hearing, May 30, 1980].

FN12. House Hearing, February 22, 1978, supra note 9, at 66-67 (testimony of Daniel I. Halperin).

FN13. The tax shelter abuse implications of bankruptcy tax law are beyond the scope of this paper.

FN14. 11 U.S.C.A. § 1141 (West 1979 & Supp. 1991).

FN15. 26 U.S.C.A. § 61(a)(12) (West 1988 & Supp. 1991).

FN16. J. Eustice, Cancellation of Indebtedness Redux: The Bankruptcy Tax Act of 1980 Proposals--Corporate Aspects, 36 TAX. L. REV. 1 (1980). For other excellent reviews of prior law, see J. Eustice, Cancellation of Indebtedness and the Federal Income Tax: A Problem of Creeping Confusion, 14 TAX L. REV. 225 (1959); B. Bittker & B. Thompson, Income From The **Discharge** of **Indebtedness:** The Progency of United States v. Kirby Lumber Co., 66 CAL. L. REV. 1159 (1978); R. Noffke, **Discharge** of **Indebtedness** Under the Bankruptcy Tax Act of 1980, 60 TAXES 635 (1982); P. Asofsky, Reorganizing Insolvent Corporations Today, 417 N.Y.U. INST. ON FED. TAX., ch. 40 (1989).

FN17. 284 U.S. 1 (1931).

FN18. Id. at 3; accord, Helvering v. American Chicle, 291 U.S. 426 (1934); Fifth Ave.-Fourteenth St. Corp. v. Comm'r, 147 F.2d 453, 456-57 (2d Cir. 1944); Commissioner v. Coastwise Transp. Corp., 71 F.2d 104, 105-06 (1st Cir.), cert. denied, 293 U.S. 595 (1934).

FN19. Dallas Transfer & Terminal Warehouse Co. v. Comm'r, 70 F.2d 95 (5th Cir. 1934); Lakeland Grocery Co., 36 B.T.A. 289 (1937); Astoria Marine Constr. Co. v. Comm'r, 12 T.C. 798 (1949); Madison Rys. v. Comm'r, 36 B.T.A. 1106 (1937); Fifth Avenue-14th St. Corp. v. Comm'r, 147 F.2d 453 (2d Cir. 1944) (defining a narrower insolvency exception: if an insolvent debtor retires its debts for less than what the creditor would receive under a liquidation analysis, the debtor recognizes as income the difference).

FN20. 11 U.S.C. §§ 670, 796, 922 (1938) (repealed).

FN21. 26 U.S.C. § 371 (1939) (repealed).

FN22. 11 U.S.C. §§ 270, 396, 522 (1940) (repealed).

FN23. 11 U.S.C. § 270 (1940) (repealed).

FN24. 26 U.S.C. §§ 371, 372 (1943) (repealed).

FN25. Commissioner v. Motormart Trust, 156 F.2d 122 (1st Cir. 1946); Alcazar Hotel Inc. v. Comm'r, 1 T.C. 872 (1943), acq., 1943 C.B. 1, 1947-1 C.B. 1; Rev. Rul. 59-222, 1959-1 C.B. 80.

FN26. S. REP. NO. 1035, 96th Cong., 2d Sess. 10 (1980) reprinted in 1980 U.S.C.C.A.N. 7225; H.R. REP. NO.

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 286

833, 96th Cong., 2d Sess. 8 (1980).

FN27. Pub. L. No. 95-598, 92 Stat. 2549, § 402(a) (1978).

FN28. **26** U.S.C.A. § **108(a)** (West 1988 & Supp. 1991).

FN29. **26** U.S.C.A. § **108(b)** (West 1988 & Supp. 1991).

FN30. **26** U.S.C.A. § **108(b)(5)** (West 1988 & Supp. 1991). Revocation of an election to reduce **bases** requires the consent of the Secretary under **26** U.S.C.A. § **108(d)(4)(B)** (West 1988 & Supp. 1991). H.R. REP. NO. 833, supra note 26, at 11; S. REP. NO. 1035, supra note 26, at 3.

FN31. **26** U.S.C.A. § **108(a)(1)** (West 1988 & Supp. 1991).

FN32. **26** U.S.C.A. § **108(b)(4)(B)** (West 1988 & Supp. 1991); net operating losses are defined at 26 U.S.C.A. § 172(c) (West 1988 & Supp. 1991).

FN33. 26 U.S.C.A. § 30 (West 1988 & Supp. 1991).

FN34. 26 U.S.C.A. § 38 (West 1988 & Supp. 1991).

FN35. **26** U.S.C.A. § **108(b)(2)(B),** (3)(B), (4)(C) (West 1988 & Supp. 1991).

FN36. 26 U.S.C.A. §§ 41, 108(b)(2)(B) (West 1988 & Supp. 1991).

FN37. **26** U.S.C.A. § **108(b)(2)(A)** and (4)(B) (West 1988 & Supp. 1991).

FN38. **26** U.S.C.A. § **108(b)(4)(B)** (West 1988 & Supp. 1991).

FN39. **26** U.S.C.A. § **108(b)(2)(D)** (West 1988 & Supp. 1991); Treas. Reg. §§ 1.1016-7 and 8 (1991).

FN40. 26 U.S.C.A. § 27 (West 1988 & Supp. 1991).

FN41. **26** U.S.C.A. § **108(b)(1)(E),** (3)(B) and (4)(C) (West 1988 & Supp. 1991).

FN42. 26 U.S.C.A. § 469 (West 1988 & Supp. 1991).

FN43. 26 U.S.C.A. § 53 (West 1988 & Supp. 1991).

FN44. **26** U.S.C.A. § **108(b)** (West 1988 & Supp. 1991).

FN45. Bankruptcy Tax Act and Minor Tax Bills: Hearing on H.R. 5043 before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means, 96th Cong., 1st Sess. 52 (1979) [hereinafter House Hearing, September 27, 1979] (Testimony of David A. Berenson).

FN46. **26** U.S.C.A. § **108(b)(5)(B)** (West 1988 & Supp. 1991).

FN47. **26** U.S.C.A. § **108(b)(5)** (West 1988 & Supp. 1991).

FN48. H.R. REP. NO. 833, supra note 26, at 11; S. REP. NO. 1035, supra note 26, at 13.

FN49. 26 U.S.C.A. § 1017 (West 1988 & Supp. 1991).

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FN50. H.R. REP. NO. 833, supra note 26, at 11; S. REP. NO. 1035, supra note 26, at 14; Treas. Reg. §§ 1.1016-7 and 1.1016-8 (1991). A debtor may be able to select certain assets for **basis** reduction upon a showing that the reduction of **basis** of numerous other items would be "burdensome and impractical." See Priv. Ltr. Rul. 88-40-006 (June 3, 1988); Priv. Ltr. Rul. 88-40-021 (June 3, 1988).

FN51. See H.R. REP. NO. 833, supra note 26, at 9; S. REP. NO. 1035, supra note 26, at 10 (1980); P. Asofsky & W. Tablock, Bankruptcy Tax Act Radically Alters Treatment of Bankruptcy and Discharging Debts, 54 J. TAX'N 109 (1981).

FN52. **26** U.S.C.A. § **108** (West 1988 & Supp. 1991).

FN53. Note that no recapture of investment tax credits is made. Rev. Rul. 84-134, 1984-2 C.B. 6; Rev. Rul. 81-206, 1981-2 C.B. 9.

FN54. 26 U.S.C.A. §§ 1017(d)(1)(A), 1245, 1250 (West 1988 & Supp. 1991).

FN55. S. REP. NO. 1035, supra note 26, at 16.

FN56. P. Asofsky, **Discharge** of **Indebtedness** Income in Bankruptcy after the Bankruptcy Tax Act of 1980, 27 ST. LOUIS U.L.J. 583, 594 (1983).

FN57. Comm'r v. Motor Mart Trust, 156 F.2d 122, 126-27 (1st Cir. 1946); Carpento Sec. Corp. v. Comm'r, 140 F.2d 382, 385 (1st Cir. 1944); Alcazar Hotel Inc. v. Comm'r, 1 T.C. 872 (1943) nonacq., 1943 C.B. 26, withdrawn, 1947-1 C.B. 1; Rev. Rul. 59-222, 1951-1 C.B. 80; Rev. Rul. 59-98, 1951-1 C.B. 76.

FN58. Tower Building Corp. v. Comm'r, 6 T.C. 125 (1946), acq., Gen. Couns. Mem. 25277, 1947-1 C.B. 44 (declared obsolete in Rev. Rul. 69-44, 1969-1 C.B. 312).

FN59. **26** U.S.C.A. § **108(e)** (8) (West 1988 & Supp. 1991). Stock that is attributable to accrued interest, however, is taxable under 26 U.S.C.A. §§ 354(a)(2)(B) and (3)(B) (West 1988 & Supp. 1991).

FN60. In 1984 Congress explicitly restricted the use of the stock for debt exception by solvent debtors not in bankruptcy. However, no mention was made of solvent debtors in bankruptcy. Arguably, the language of § 108 restricts the use of the stock for debt exception by a solvent debtor in bankruptcy as well. The 1984 amendment provides that the stock for debt exception "shall not apply in the event of a debtor in a title 11 case or to the extent the debtor is solvent" (emphasis added). Thus, the literal language of the statute suggests that solvency can be a bar to use of the stock for debt exception even for debtors in bankruptcy. On the other hand, the legislative history explicitly allows use of the stock for debt exception without qualification for all debtors in bankruptcy: "this rule will not apply to solvent corporations or to corporations in a title 11 case" (emphasis added). Although the legislative history is unambiguous, given the Treasury policies to encourage equal treatment of debtors in bankruptcy and debtors not in bankruptcy, and to encourage a fresh start but not a "head start," a Treasury challenge to stock for debt exchanges involving solvent corporations in bankruptcy is possible.

FN61. **26** U.S.C.A. § **108(e)(8)(A)** (West 1988 & Supp. 1991); S. REP. NO. 1035, supra note 26, at 17; H.R. REP. NO. 833, supra note 26, at 14.

FN62. H.R. REP. NO. 833, supra note 26, at 14.

FN63. S. REP. NO. 1035, supra note 26, at 17.

FN64. 126 CONG. REC. H12, 459; H12, 462 (1980).

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FN65. Priv. Ltr. Rul. 80-14-091 (Jan. 11, 1990); Priv. Ltr. Rul. 80-21-144 (Feb. 29, 1980); Priv. Ltr. Rul. 81-10-139 (Dec. 12, 1980); Priv. Ltr. Rul. 78-21-047 (Feb. 23, 1978).

FN66. Treas. Reg. § 1.351-1(a)(1)(ii) (1991).

FN67. B. Mirskey & R. Willens, The Bankruptcy Tax Act of 1980, 59 TAXES 145, 149 (1981); CCH Tax Transactions Library, Failed and Failing Businesses ¶ 5.041 (1988).

FN68. Priv. Ltr. Rul. 88-37-002 (May 10, 1988).

FN69. Failed and Failing Businesses, supra note 67, at ¶ 5.041.

FN70. **26** U.S.C.A. § **108(e)(8)(B)** (West 1988 & Supp. 1991); S. REP. NO. 1035, supra note 26, at 17.

FN71. S. REP. NO. 1035, supra note 26, at 17.

FN72. **26** U.S.C.A. § **108(e)(7)(A),** (B) (West 1988 & Supp. 1991).

FN73. Failed and Failing Businesses, supra note 67, at ¶ 5.07 p. 532; G. Henderson, Developing a Tax Strategy for the Failing Company, 63 TAXES 952, 960 (1985).

FN74. Failed and Failing Businesses, supra note 67, at ¶ 5.07 p. 532.

FN75. 11 U.S.C.A. § 1141 (West 1979 & Supp. 1991).

FN76. Failed and Failing Businesses, supra note 67, at ¶ 5.07 p. 532; R. Witt & F. Albergotti, G Reorganizations Offers Simple, Effective Way to Acquire Bankruptcy Corporations, 63 J. TAX'N 90 n.28 (1985).

FN77. Carroll-McCreary Co. v. Comm'r, 124 F.2d 303, 305 (2d Cir. 1941); Comm'r v. Auto-Stop Safety Razor Co., 74 F.2d 226 (2d Cir. 1934); Hartland Associates, 54 T.C. 1580, 1585-87 (1970), nonacq. 1976-2 C.B. 3.

FN78. **26** U.S.C.A. § **108(e)(6)** (West 1988 & Supp. 1991).

FN79. General Utilities Operating Co. v. Helvering, 296 U.S. 200 (1935).

FN80. Moline Properties, Inc. v. United States, 319 U.S. 436 (1943).

FN81. House Hearing, September 27, 1979, supra note 45, at 54 (testimony of David A. Berenson); Senate Hearing, May 30, 1980, supra note 11, at 322 (testimony of Robert H. Lipsey).

FN82. P. Asofsky, supra note 56, at 613, 615; G. Henderson, supra note 73, at 959.

FN83. 109 B.R. 51 (Bankr. S.D.N.Y. 1990) See also, C. Coombs, Original Issue Discount in Debt-for-Debt and Debt-for-Stock Exchanges, 65 AM. BANKR. L.J. 649 (1991).

FN84. H.R. REP. NO. 881, 101st Cong., 2d Sess. 355 (1990), reprinted in 1990 U.S.C.C.A.N. 2017, 2357.

FN85. Senate Hearing, May 30, 1980, supra note 11, at 265 (testimony of David J. Shakow); M. CHIRLSTEIN, FEDERAL INCOME TAXATION ¶ 3.02 (4th ed. 1985); Treas. Reg. § 1.61-12(a) (1991).

FN86. See, e.g., Parkford v. Comm'r, 133 F.2d 249 (9th Cir. 1943); Home Builders Lumber Co. v. Comm'r, 165 F.2d 1009 (5th Cir. 1948).

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FN87. Senate Hearing, May 30, 1980, supra note 11, at 20 (testimony of Charles M. Walker).

FN88. See infra notes 191-210 and accompanying text.

FN89. See infra notes 191-210 and accompanying text.

FN90. 26 U.S.C.A. § 1012 (West Supp. 1991).

FN91. New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934).

FN92. 26 U.S.C. § 202(6) (1918) (repealed).

FN93. 26 U.S.C. §§ 203(6)(3), 204(a)(7) (1924) (repealed).

FN94. 26 U.S.C. § 381 (1954) (repealed).

FN95. 26 U.S.C. § 112(i)(1)(A) (1932) (repealed).

FN96. Pinnellas Ice & Cold Storage Co. v. Comm'r, 287 U.S. 462 (1933).

FN97. W. Plumb, The Bankruptcy Tax Act, 33 U.S.C. LAW CENTER TAX INST. ¶ 801.1 (1981).

FN98. See infra note 107 and accompanying text.

FN99. Helvering v. Southwest Consolidated Corp., 315 U.S. 194 (1942).

FN100. The bankruptcy rules under § 368 apply not only to title 11 cases, but also to receiverships, foreclosures, and similar proceedings in state and federal court. 26 U.S.C.A. § 368(a)(3)(A) (West 1988 & Supp. 1991).

FN101. 26 U.S.C.A. § 368(a)(1)(G) (West 1988 & Supp. 1991).

FN102. S. REP. NO. 1035, supra note 26, at 35.

FN103. H.R. REP. NO. 833, supra note 26, at 31; S. REP. NO. 1035, supra note 26, at 36.

FN104. Helvering v. Minnesota Tea Co., 296 U.S. 378 (1935); Pinellas Ice & Cold Storage Co. v. Comm'r, 287 U.S. 462 (1933).

FN105. Rev. Proc. 77-37, 1977-2 C.B. 568.

FN106. See, e.g., Nelson Co. v. Helvering, 296 U.S. 374 (1935); Miller v. Comm'r, 84 F.2d 415 (6th Cir. 1936).

FN107. Treas. Reg. § 1.371-1(a)(4) (1991).

FN108. 315 U.S. 179 (1942).

FN109. S. REP. NO. 1035, supra note 26, at 37. This statement reflects the holding of Atlas Oil & Refining Corp. v. Comm'r, 36 T.C. 67 (1961).

FN110. Absolute priority in these circumstances refers generally to the seniority of creditors. However, no explicit ranking of seniority exists for tax purposes. In contrast, absolute priority for bankruptcy purposes is defined in § 726 of the Bankruptcy Code. See also 11 U.S.C.A. § 1129(b) (West 1979 & Supp. 1991).

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 290

FN111. P. Asofsky, Reorganizing Insolvent Corporations, 41 N.Y.U. INST. ON FED. TAX'N. § 5.02(2) (1982); Montgomery Bldg. Realty Co. v. Comm'r., 7 T.C. 417 (1946); Rex Mfg. Co. v. Comm'r., 102 F.2d 325 (7th Cir. 1939).

FN112. H.R. REP. NO. 833, supra note 26, at 31-32; S. REP. NO. 1035, supra note 26, at 36-37.

FN113. Priv. Ltr. Rul. 85-03-064 (Oct. 24, 1984).

FN114. Priv. Ltr. Rul. 85-21-083 (Feb. 27, 1985).

FN115. P. Asofsky, supra note 111, at § 5.02(2).

FN116. Gregory v. Helvering, 293 U.S. 465, 469 (1935).

FN117. Treas. Reg. § 1.368-a(b) (1991).

FN118. See Pridemark Inc. v. Comm'r, 345 F.2d 35 (4th Cir. 1965); Standard Realization Co., 10 T.C. 708 (1948).

FN119. Treas. Reg. § 1.368-1(d) (1991).

FN120. 26 U.S.C.A. § 368(a)(1)(G) (West 1988 & Supp. 1991).

FN121. S. REP. NO. 1035, supra note 26, at 35.

FN122. 26 U.S.C.A. § 354(a) (West 1988 & Supp. 1991).

FN123. S. REP. NO. 1035, supra note 26, at 35.

FN124. Priv. Ltr. Rul. 88-36-058 (June 16, 1988).

FN125. Priv. Ltr. Rul. 85-03-064 (Oct. 24, 1984) ("at least one person or entity which holds a security issued by Target will receive acquiring preferred stock in exchange for their security.")

FN126. 26 U.S.C.A. § 354(b) (West 1988 & Supp. 1991).

FN127. Rev. Proc. 77-37 § 3.02, 1977-2 C.B. 568, 569.

FN128. See, e.g., Atlas Tool Co. v. Comm'r, 70 T.C. 86 (1978), aff'd, 614 F.2d 860 (3d Cir. 1980), cert. denied, 449 U.S. 836 (1980) (25% of gross assets transferred); American Mfg. Co. v. Comm'r, 55 T.C. 204 (1970) (19.17% of gross assets transferred); Smothers v. United States, 79-1 U.S.T.C. ¶ 9216 (S.D. Tex. 1979), aff'd, 642 F.2d 894 (5th Cir. 1981) (15% of net assets transferred).

FN129. Such transfers might violate the "substantially all" test. See Helvering v. Elkhorn Coal Co., 95 F.2d 732 (4th Cir. 1938).

FN130. H.R. REP. NO. 833, supra note 26, at 31; S. REP. NO. 1035, supra note 26, at 35-36.

FN131. Priv. Ltr. Rul. 85-03-064 (Oct. 24, 1984).

FN132. G. Henderson, supra note 73, at 967.

FN133. New York State Bar Ass'n Tax Section Comm. on Bankruptcy, Report on Reorganizations under Section

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 291

368(a)(1)(G): Recommendations for Proposed Regulations 16 n.23 (Oct. 25, 1985) (available from the New York State Bar Ass'n) [hereinafter NYSBA].

FN134. S. REP. NO. 1035, supra note 26, at 36.

FN135. NYSBA, supra note 133, at 17 n.24.

FN136. 26 U.S.C.A. § 361(b)(1) (West 1988 & Supp. 1991).

FN137. 26 U.S.C.A. § 356 (West 1988 & Supp. 1991).

FN138. See infra notes 191-210 and accompanying text.

FN139. See infra notes 191-210 and accompanying text.

FN140. House Hearing, February 22, 1978, supra note 9, at 68 (testimony of Elmer Dean Martin III).

FN141. P. Rizzi, Section 382 and the Trigger Rules: Is Congress Beating a Dead Horse?, 14 J. OF CORP. TAX'N 99, 116 (1987) (emphasis in original).

FN142. 1918 Revenue Act, § 204, Pub. L. No. 254, 40 Stat. 1057; Revenue Act of 1950, § 215(a), Pub. L. No. 81-814, 64 Stat. 906; Small Business Tax Revision Act of 1958, §§ 172(b)(1)(A) and (B), 203, Pub. L. No. 85-866, 72 Stat. 2549; Trade Expansion Act of 1962, § 317(b), Pub. L. No.. 87-508, 76 Stat. 114.

FN143. 282 U.S. 435 (1934).

FN144. B. BITKER & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 16 02.2 (5th ed. 1988).

FN145. Id.

FN146. 26 U.S.C.A. § 269 (West 1988 & Supp. 1991).

FN147. VGS Corp. v. Comm'r, 68 T.C. 563 (1977); D'Arcy-Mac Manust Masius Inc. v. Comm'r, 63 T.C. 440 (1975); Clarksdale Rubber Co. v. Comm'r, 45 T.C. 234 (1965); Naeter Bros. Publishing Co. v. Comm'r, 42 T.C. 1 (1964); Baton Rouge Supply Co. v. Comm'r, 36 T.C. 1 (1961); Barclay Co. v. Comm'r, 23 T.M.C. 1965 (1964); See R. Rizzi, supra note 141, at 101-04.

FN148. 353 U.S. 382 (1957).

FN149. H.R. REP. NO. 841, 99th Cong., 2d Sess. II-194 (1986), reprinted in 1986 U.S.C.C.A.N. 4282.

FN150. Treas. Reg. §§ 1.1502-1 (g); 1.1502-21(d) (1991).

FN151. Tax Reform Act of 1986, Pub. L. No. 99-514, § 621(f)(5).

FN152. Carryover of Net Operating Losses and Other Tax Attributes of Corporations: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means, 99th Cong., 1st Sess. (1985) [hereinafter House Hearing, September 30, 1985] (testimony of William D. Andrews).

FN153. R. Jacobs, Tax Treatment of Corporate Net Operating Losses and Other Tax Attribute Carryovers, 5 VA. TAX REV. 701 (1985). For discussion of the neutrality principle and related ideas, see Report of the Staff of the

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 292

Senate Finance Report, S. REP. NO. 47, 99th Cong., 1st Sess. (1985); New York State Bar Association, Tax Section Committee on Net Operating Losses, The Net Operating Loss Provisions of the House-Passed Version of H.R. 3838, 31 TAX NOTES 1217 (1986) [hereinafter "New York State Bar Report"]; R. Wooton, Section 382 After the Tax Reform Act of 1986, 64 TAXES 874 (1986); J. Eustice, Alternatives for Limiting Loss Carryovers, 22 SAN DIEGO L. REV. 149 (1985).

FN154. 26 U.S.C.A. § 382 (West 1988 & Supp. 1991).

FN155. 26 U.S.C.A. § 382(g)(A)(i) (West 1988 & Supp. 1991).

FN156. H.R. REP. NO. 841, 99th Cong., 2d Sess. II-174 (1985). Changes in percentage ownership may be disregarded if they are attributable solely to fluctuations in value. Rev. Rul. 87-73.

FN157. 26 U.S.C.A. § 382(g)(3)(A)(i) (West 1988 & Supp. 1991).

FN158. Under the provisions of the Omnibus Budget Reconciliation Act of 1987, if a worthless stock deduction is claimed by a shareholder who during the three-year testing period owned 50% or more of the stock of the loss corporation, no net operating loss carryovers can offset the corporation's post-change income. 26 U.S.C.A. § 382(g)(4)(D) (West 1988 & Supp. 1991). This provision is apparently intended to reverse the result of Textron, Inc. v. United States, 561 F.2d 1023 (1st Cir. 1977), which held that, in the context of a deduction claimed by a parent for worthless stock of a non-consolidated subsidiary, the net operating loss carryovers of the subsidiary survived to offset the subsidiary's future income. The 1987 Act avoids the whipsaw problem created by allowing the parent corporation a deduction and at the same time allowing the subsidiary corporation a deduction for the same economic loss. Since the statute is drafted more broadly than the problem it attempts to solve, new problems arise. First, taxpayers must ascertain the deduction taken by any 50% shareholder. It is arguably unfair, however, to have one taxpayer's tax burden dependent upon the treatment of items by another taxpayer. See Moline Properties Inc. v. United States, 319 U.S. 436 (1943); see also text accompanying note 80 supra. Second, the 1987 provision is inserted in § 382(g), the same subsection that aggregates all less-than-five-percent shareholders into one five-percent shareholder. In the context of a bankruptcy all shareholders who are wiped out can take worthless security deductions. Thus, if 50% of those shareholders take worthless security deductions, those shareholders might be aggregated under § 382(g), and net operating loss carryovers would be denied. Presumably, this result was not intended by the statute.

FN159. 26 U.S.C.A. § 382(k)(6)(A) (West 1988 & Supp. 1991); Treas. Reg. § 1.382-2T(f)(18)(i) (1991); Priv. Ltr. Rul. 89-40-006 (Apr. 20, 1989).

FN160. Despite a debtor's inability to issue nonvoting equity securities, the temporary regulations outline a procedure for excluding from the definition of "stock" interests that would otherwise qualify as stock. Temp. Treas. Reg. §§ 1.382(i)(6)(A) and (K)(6)(ii) (under authority of 26 U.S.C.A. § 382(k)(6)(A) (West 1988 & Supp. 1991)). If all three of the following tests are satisfied, stock does not count as "stock" for § 382 purposes:

1) participation in future growth of the corporation is "disproportionately small" relative to the value of the stock compared to the total value of outstanding stock;

2) treating the stock as non-stock would result in an ownership change; and

3) the amount of pre-change loss exceeds twice the amount obtained by multiplying the value of the loss corporation by the long-term tax-exempt rate.

The regulations provide no objective guideline or safe harbor provisions for measuring whether participation in future growth is "disproportionately small." Because the second element is mandatory and the Congressional intent in allowing the Regulations was to prevent avoidance of the § 382 limitation, H.R. REP. NO. 841, 99th Cong., 2d Sess. II-173 (1986), it is unlikely that debtors in bankruptcy can take advantage of the provisions.

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FN161. 26 U.S.C.A. § 382(a) (West 1988 & Supp. 1991). See text accompanying notes 152-53 supra.

FN162. 26 U.S.C.A. § 382(b)(1) (West 1988 & Supp. 1991).

FN163. 26 U.S.C.A. § 382(e)(1) (West 1988 & Supp. 1991).

FN164. 26 U.S.C.A. § 382(1)(6) (West 1988 & Supp. 1991).

FN165. H.R. REP. NO. 841, supra note 149, at II-189.

FN166. 26 U.S.C.A. § 382(c) (West 1988 & Supp. 1991); S. REP. NO. 841, supra note 149, at II-194.

FN167. Treas. Reg. § 1.368-1(d) (1991).

FN168. House Hearing, September 30, 1985, supra note 152 (testimony of Richard Bacon).

FN169. R. Reynolds, Revision of NOL and Credit carryover Rules, 986 Tax Mgmt. (BNA) ch. 35 n.42 and accompanying text (1988). The same reason applies to the continued application of single return limitation year and consolidated returns change in ownership regulations. P. Asofsky, supra note 16, at § 40.07(5) and (6).

FN170. 26 U.S.C.A. § 382(1)(4)(A) (West 1988 & Supp. 1991).

FN171. 26 U.S.C.A. § 382(h)(1)(A) (West 1988 & Supp. 1991).

FN172. 26 U.S.C.A. § 382(h)(3)(B) (West 1988 & Supp. 1991).

FN173. 26 U.S.C. § 382(b) (1985) (repealed).

FN174. 26 U.S.C. § 382(d) (1985) (repealed).

FN175. Staff of Senate Finance Committee, 99th Cong., 1st Sess., "The Subchapter C Revision Act of 1985" 250 (1985).

FN176. 26 U.S.C.A. § 382(1)(5)(A) (West 1988 & Supp. 1991); H.R. REP. NO. 841, supra note 149, at II-192. Note that the same issues relevant to the timing of a stock for debt exchange apply with equal force to the timing of ownership change under the net operating loss carryover rules. See notes 73-76 supra and accompanying text. The Internal Revenue Service, in letter rulings, suggests that the "testing date" for determining an ownership change is the confirmation date of a chapter 11 plan. Priv. Ltr. Rul. 89-02-047 (Oct. 28, 1988); Priv. Ltr. Rul. 90-15-033 (Jan. 16, 1990); Priv. Ltr. Rul. 90-19-036 (Feb. 9, 1990). Deeming the confirmation date to be the date of ownership change could undermine reorganizations that are subject to appeal, insofar as additional claimants and additional purchasers of the debtor's equity may surface between the confirmation date and the date that the plan ultimately becomes effective, thus changing the identity of those entitled to stock. If the change in ownership is substantial, a second ownership change could be imminent.

FN177. 26 U.S.C.A. § 382(1)(5)(e) (West 1988 & Supp. 1991); H.R. REP. NO. 841, supra note 149, at II-192.

FN178. House Hearing, September 30, 1985, supra note 152 (testimony of Assistant Secretary of the Treasury Pearlman).

FN179. See R. Jacobs, supra note 153, at 729-36.

FN180. 26 U.S.C.A. § 382(1)(5)(C) (West 1988 & Supp. 1991).

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FN181. 26 U.S.C.A. § 382(1)(5)(B) (West 1988 & Supp. 1991).

FN182. 26 U.S.C.A. § 382(1)(5)(D) (West 1988 & Supp. 1991).

FN183. R. Jacobs, supra note 153, at 723.

FN184. House Hearing, September 30, 1985, supra note 152 (testimony of Assistant Secretary of Treasury Pearlman).

FN185. See, e.g., Priv. Ltr. Rul. 89-02-047 (Oct. 28, 1988); Priv. Ltr. Rul. 89-04-040 (Sept. 11, 1989); Priv. Ltr. Rul. 90-19-036 (Feb. 9, 1990).

FN186. See Official Committee v. PSS S.S. Co. (In re Prudential Lines, Inc.), 928 F.2d 565 (2d Cir. 1991).

FN187. R. Jacobs, supra note 153, at 724.

FN188. H.R. REP. NO. 841, supra note 149, at II-192.

FN189. New York State Bar Report, supra note 153, at 1240.

FN190. House Hearing, September 30, 1985, supra note 152 (testimony of Assistant Secretary of the Treasury Pearlman).

FN191. 11 U.S.C.A. § 1129(b) (West 1979 & Supp. 1991).

FN192. 11 U.S.C.A. § 1129(a)(11) (West 1979 & Supp. 1991).

FN193. 11 U.S.C.A. § 1129(a)(3) (West 1979 & Supp. 1991).

FN194. 11 U.S.C.A. § 1129(d) (West 1979 & Supp. 1991).

FN195. 26 U.S.C.A. § 7421 (West 1988 & Supp. 1991).

FN196. 28 U.S.C.A. § 2201 (West 1984 & Supp. 1991).

FN197. 241 F.2d 374 (6th Cir.) cert. denied, 355 U.S. 838 (1957).

FN198. 412 F.2d 1048 (5th Cir. 1969).

FN199. H.R. REP. NO. 595, supra note 4, at 421; 124. Cong. Rec. H 11,115 (September 28, 1978); S 17,432 (Oct. 6, 1978).

FN200. The limitation on questions of fact may be appropriate given the necessity of a thorough audit to fix tax liabilities exactly.

FN201. Bankruptcy Reform Act, Hearings on S.235 and S.236 before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary, 94th Cong., 1st Sess. 792 (1975) (testimony of Donald C. Alexander, Commissioner of Internal Revenue).

FN202. Bankruptcy Act Revision, Hearings on H.R. 31 and H.R. 32 Before the House Comm. on the Judiciary, 94th Cong., 2d Sess. 1964 (1976) (testimony of Donald C. Alexander, Commissioner of Internal Revenue).

FN203. H.R. REP. NO. 595, supra note 4, at 3; K. Klee, Legislative History of the New Bankruptcy Law, 28

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DEPAUL L. REV. 941, 948 (1979).

FN204. Bankruptcy Reform Act of 1978, Hearing on Sections 346, 505, 507, 523, 728, 1146 and 1331 of § 2266 before the Subcomm. on Tax'n and Debt Management Generally of the Senate Comm. on Finance, 95th Cong., 2d Sess. 20 (1978) (testimony of Daniel I. Halperin, Deputy Assistant Secretary of the Treasury).

FN205. Id. at 30.

FN206. S. REP. NO. 110, 95th Cong., 2d Sess. 28 (1978).

FN207. House Hearing, September 27, 1979, supra note 45, at 187, 193.

FN208. 26 U.S.C.A. § 7428 (West 1988 & Supp. 1991).

FN209. 26 U.S.C.A. § 7476 (West 1988 & Supp. 1991).

FN210. 26 U.S.C.A. § 7478 (West 1988 & Supp. 1991).

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DATE AND TIME PRINTING STARTED:	05/11/95	10:16:15 am (Central)
DATE AND TIME PRINTING ENDED:	05/11/95	10:21:02 am (Central)
OFFLINE TRANSMISSION TIME:		00:04:47
NUMBER OF REQUESTS IN GROUP:	2	
NUMBER OF LINES CHARGED:	2521	

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Law Review Articles.
28 U.S.C. § 455(a)

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 298

Temple Law Quarterly

Fall, 1987

Comment

*697 QUESTIONING THE IMPARTIALITY OF JUDGES: DISQUALIFYING FEDERAL DISTRICT COURT JUDGES UNDER 28 U.S.C. § 455(a)

Susan B. Hoekema

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INTRODUCTION

An impartial judiciary is an essential element of the system of justice in the United States. The right to a 'neutral and detached judge' in all proceedings is protected by the Constitution. [FN1] In addition, an impartial judiciary is essential to maintain public confidence in the integrity of the judicial system. [FN2] Throughout the history of our national government, Congress has sought to secure the impartiality of trial judges by requiring judges to disqualify themselves in various circumstances. [FN3]

Congress revised the federal disqualification law in 1974, and instituted an objective standard for disqualification in place of a subjective standard. [FN4] As stated in 28 U.S.C. § 455(a), the objective disqualification requirement mandates disqualification when a reasonable person would question a judge's impartiality. [FN5]

Since the objective standard was adopted, however, judicial interpretation of section 455(a) has narrowed the broad scope Congress intended for disqualification law. [FN6] Federal courts have limited the scope of the current statutory provisions *698 by requiring a high standard of proof of bias [FN7] and by applying judicially-created rules restricting the circumstances in which bias can be found. [FN8] In addition, the procedures for disqualification cast into doubt the objectivity of disqualification decisions. [FN9] The procedures allow the challenged judge to make the disqualification decision. If a judge refuses to disqualify himself, review is not always immediately available and appellate courts tend to defer to the initial judgment of the district court. [FN10]

This comment will review current standards and procedures required by statute and applied to judicial disqualification by the courts. It will assess the extent to which current interpretations conform to the objective standard set forth in section 455(a) and explore ways in which disqualification decisions may be made on a more objective basis.

I. STATUTORY PROVISIONS FOR DISQUALIFICATION

Two provisions of federal law furnish the means for disqualifying district court judges. [FN11] The paramount disqualification statute is 28 U.S.C. § 455. [FN12] Section 455(a) sets forth a general provision mandating disqualification whenever *699 a reasonable person would question a judge's impartiality. [FN13]

Section 455(b) requires disqualification in several specified circumstances. [FN14] A judge is disqualified if he or she has a financial interest in a case, [FN15] defined by the statute as 'ownership of a legal or equitable interest, however small, or a relationship as director, adviser, or other active participant in the affairs of a party.' [FN16] Section 455(b) also mandates disqualification if the persons involved in the litigation are related to the judge 'within the third degree of [blood] relationship.' [FN17] The statute also provides for disqualification if the

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 299

judge has a professional relationship with a party, including representation of a party by the judge or by a member of the judge's former firm. [FN18] Judges who have been in government employment must disqualify themselves from proceedings in which they had a role and from cases about which they have expressed an opinion on ***700** the merits. [FN19] Section 455(b) also requires disqualification when a judge has 'a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding.' [FN20]

Parties cannot waive their right to disqualification when it is based on one of the grounds specified in section 455(b). [FN21] When the disqualification is based on section 455(a), however, waiver is permitted upon full disclosure of the basis for disqualification. [FN22]

Section 455 places responsibility for disqualification on the judge. [FN23] This action can be taken sua sponte. [FN24] Courts also permit disqualification to be prompted by a party either by motion or on appeal. [FN25]

Section 455 was significantly revised in 1974. [FN26] A major concern of Congress was to eliminate the subjective opinion of the judge as the basis for determining disqualification. [FN27] The superseded version of section 455 required ***701** disqualification if, 'in his opinion,' it was improper for a judge to sit during the proceedings. [FN28] Congress replaced this subjective standard with an objective standard that obliges judges to disqualify themselves when their impartiality 'might reasonably be questioned.' [FN29] In instituting this objective standard, Congress stressed that it was doing away with the 'duty to sit' rule, requiring that a judge should stay with the case when it doubt about disqualification. [FN30]

The general disqualification standard set forth in section 455(a) cannot be understood without analysis of two other disqualification provisions--section 455(b)(1) and 28 U.S.C. § 144, both of which disqualify a judge for personal bias and prejudice. [FN31] A party moving for disqualification under section 455(a) frequently seeks disqualification under both section 455(b)(1) and 144 as well. [FN32] Furthermore, interpretation of section 455(a) has been shaped by judicial interpretation of section 144, which predated the revised general disqualification ***702** statute. [FN33]

Section 144, first enacted in 1911, [FN34] focuses exclusively on bias and prejudice as grounds for disqualification. [FN35] It authorizes a litigant with the power to disqualify a district court judge by means of a 'timely and sufficient affidavit' alleging 'personal bias or prejudice' for or against a party. [FN36] The key to disqualification under section 144 is the sufficiency of the affidavit. As long as procedural rules regarding the form and timing of the affidavit are met, [FN37] the filing of a legally sufficient affidavit compels a judge to transfer the case to another district court judge. [FN38]

As the Supreme Court determined in Berger v. United States, [FN39] the challenged judge must take the initial step of evaluating the sufficiency of the affidavit, and may not automatically transfer the case when an affidavit is filed. [FN40] Thus, section 144 does not provide for peremptory challenge of the judge. [FN41] Instead, a judge is required to evaluate the legal sufficiency, but not the truth, of ***703** the allegations. [FN42] Standards for determining legal sufficiency have developed in case law, interpretating the meaning of 'personal' bias or prejudice. [FN43]

Section 455(b)(1) echoes the personal prejudice language of section 144, disqualifying where a judge 'has a personal bias or prejudice' concerning a party. [FN44] The vagueness of language in this provision contrasts sharply with the other sections of 455(b), in which Congress spelled out in detail the amount and type of financial interest, and the degree of relationship to a participant or prior involvement in a case that necessitates disqualification. [FN45] Section 455(b)(1) uses undefined terms and provides no concrete guidelines for determining bias or prejudice. [FN46] This vagueness reflects the difficulties inherent in providing standards for disqualification on grounds of bias or prejudice. Such standards are hard to state; when concrete phrases are substituted for a vague statement of objectives, they are subject to the criticism of being underinclusive. [FN47]

Both Congress and the American Bar Association ('ABA') encountered this difficulty in their attempts to frame

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the bias and prejudice provisions of their respective codes. One of the earlier drafts of the Senate bill required disqualification when a judge 'has a fixed belief concerning the merits of the matter in controversy or personal knowledge of material facts.' [FN48] This language was later replaced with the language of section 455(b)(1), requiring disqualification where a judge 'has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceedings.' [FN49] The change followed the alternations made in the ABA Code of Judicial Conduct. The 'fixed belief' language in the first ABA draft was abandoned in response to criticism that it would predispose judges to disqualification for having an understanding of the law and a commitment to uphold it. [FN50] The final draft of the Senate bill, like the final ABA draft, returned to the 'personal bias or prejudice' language ***704** of section 144, [FN51] and thus premitted courts to apply the judicial gloss built up over the years on section 144 to section 455. [FN52]

II. APPLYING THE DISQUALIFICATION STATUTES

Application of section 455(a), [FN53] the general federal disqualification statute, has been shaped in part by courts' concern to balance the advantages of disqualification with countervailing judicial interests. [FN54] On the one hand, disqualification of judges whenever reasonable doubt arises concerning their impartiality promotes public confidence in the judiciary. Conversely, disqualification may diminish the efficiency of the judicial system. [FN55] Transferring a case always creates some administrative costs, and when disqualification occurs in a complex case some time after the case has commenced in the court, the burden may be substantial. [FN56] Although courts may be tempted to give significant weight to efficiency, Congress' elimination of the duty to sit rule indicates that the goal of impartiality should be paramount whenever there are reasonable grounds for disqualification. [FN57] Congress and the courts also face the concern that litigants will manipulate disqualification to their advantage or to the disadvantage of their opponents by judge-shopping or by causing costly delays. [FN58]

***705** Courts have had the opportunity to shape disqualification standards under section 455(a) through their interpretation of the law in two areas of inquiry. One question facing the courts concerns what constitutes reasonable grounds for disqualification. The substantive requirements for disqualification which have been developed through this inquiry will be discussed in section B below. [FN59] Another question facing the courts is whether, and to what extent, the appearance of bias justifies disqualification. Is it appropriate to disqualify a judge on the appearance of bias or is it, at least in some cases, necessary to establish bias in fact? The interpretations offered in each of these areas determine the reach of federal disqualification, its availability in particular cases, and the appealability of the denial of disqualification.

A. Assessing Bias: Standards of Proof

The question whether disqualification should rest on the appearance or the fact of bias arises because the two objectives of disqualification law--promoting confidence in the judiciary and providing a fair trial to litigants--differ in focus. Protection of individual rights requires disqualification of judges who will not consider particular cases with impartiality. Protecting and promoting public confidence in the judiciary, in contrast, depends not only on actual fairness in particular cases but also on the appearance of fairness. [FN60] Disqualification based on the appearance of bias may be required to promote public confidence when, in fact, no actual partiality exists. [FN61]

In many circumstances where federal law requires disqualification, concerns for judicial appearance and individual fairness are both present. But some circumstances may involve only one of these objectives. On the one hand, fairness may require disqualification in situations where there is no appearance of partiality and the need for disqualification is not known to anyone but the judge. [FN62] Public appearances, on the other hand, may require assigning another judge even in cases where litigants are confident they would be treated fairly by the disqualified judge. [FN63]

***706** Analysis of the language of the disqualification statutes suggests that both 28 U.S.C. §§ 144 and 455(b)(1) can be interpreted as requiring bias in fact. [FN64] Section 144 requires that the affidavit state facts sufficient to

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establish bias. [FN65] Section 455(b)(1) states that a judge 'shall . . . disqualify himself . . . [w]here he has a personal bias or prejudice. . . .' [FN66] The same objective standard applied to these statutes is also applied to section 455(a), [FN67] however, and thus bias in fact cannot be established by subjective assessment of the judge's state of mind. Instead, courts have required that a litigant seeking disqualification meet a higher standard of proof to show bias in fact. [FN68]

A higher standard of proof is firmly established as part of the disqualification process under section 144. When scrutinizing the affidavit to determine whether it is legally sufficient, [FN69] courts apply a 'clear and convincing' standard, and evaluate whether the facts 'would convince a reasonable man that bias exists.' [FN70] In contrast, courts have not asked whether the facts would cause a reasonable person to question the judge's impartiality under section 144. [FN71] Imposing a stricter standard of proof for disqualification under section 144 provides a reasonable counterbalance to the stipulation that the judge accept all the averments in a section 144 affidavit as true. [FN72] This more rigorous standard of proof does not, however, ensure that judges are disqualified under section 144 only where there is bias in fact. The requirement that the facts be taken as true, ***707** even where the judge knows them to be false, [FN73] delimits the court's assessment of the facts, making it inaccurate to describe section 144 as a statute that disqualifies only for a actual bias.

Whether the 'clear and convincing' standard of proof should be applied to section 455(b)(1) has seldom been addressed by the courts. Most courts treat section 455(a) as predominant, rest their decision on that section when bias or prejudice is alleged, and avoid the issue of whether they are required to make a finding of actual bias under section 455(b)(1). [FN74] Other courts interpret section 455(b)(1) as providing a specific example of grounds for disqualification under section 455(a) and apply to section 455(b)(1) the standard they apply to section 455(a). [FN75] In United States v. Balistrieri, [FN76] the United States Court of Appeals for the Seventh Circuit held that section 455(b)(1) requires that actual bias be found in order to meet that section's standard of proof. [FN77] The court applied the 'clear and convincing' standard, asking whether a reasonable person with knowledge of all the facts would be convinced that the judge was biased. [FN78]

***708** The language of section 455(a) suggests that it requires disqualification for the appearance of bias. [FN79] The section mandates disqualification when a reasonable person would question a judge's impartiality, regardless whether actual bias exists. [FN80] Clear and convincing evidence is not required by the language of the statute. [FN81] Moreover, disqualification when doubt about impartiality exists, rather than only when convincing evidence of bias is produced, is in keeping with the congressional aim to eliminate the duty to sit rule and replace it with the rule that judges, when uncertain, should disqualify themselves. [FN82]

Courts generally apply the reasonable doubt standard to section 455(a) disqualification and disqualify for the appearance of bias. [FN83] However, the standard of proof for disqualification under section 455(a) was subject to controversy for a time during which some courts of appeals' decisions were interpreted as equating section 455(a) with section 144 and requiring the same 'clear and convincing' standard of proof. [FN84] This position appears to have been abandoned. [FN85]

Recently, however, a new controversy has arisen. The Seventh Circuit has limited appellate review of disqualification under section 455(a) because that section disqualifies based on the appearance of bias or prejudice. [FN86] After requiring ***709** proof of bias in fact under section 455(b)(1) in Balistrieri, [FN87] the Seventh Circuit refused to consider whether the judge should have recused himself from the case under section 455(a). Rather, the court held that the denial of disqualification under section 455(a) is not reviewable on post-trial appeal because disqualification under that section does not rest on actual bias. [FN88] The court reasoned that because the standard in section 455(a) is the appearance of bias, in contrast to the actual bias standard of section 455(b), section 455(a) does not implicate the substantive rights of the parties. [FN89] The court characterized section 455(a) as aimed only at protecting against injury to the judicial system as a whole, and further suggested that a pretrial mandamus petition provides the only appropriate vehicle for review. [FN90]

This distinction could severely limit the number of disqualification denials that could be heard on appeal.

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Courts tend to focus on section 455(a) when considering disqualification and thus may not develop a record that will permit full consideration of whether disqualification could be supported by clear and convincing evidence. [FN91] In addition, questions regarding the impartiality of judges do not only arise before trial, but instead may come to the attention of a party during or after trial. [FN92]

More fundamentally, the legislative history of section 455 does not support a bifurcation of the focus and reviewability of its subsections. Section 455(a) is not accurately characterized as directed solely toward appearances and thus does not compel the Balestrieri court's interpretation. Advocates of section 455(a) described it as a provision that would enhance public confidence, [FN93] but it was not proposed exclusively for that purpose. Instead, members of Congress and the ABA Judicial Conduct Committee viewed section 455(a) as a provision that would fill in gaps and provide a requirement for disqualification in circumstances not covered by the specific standards set forth in section 455(b). [FN94] The Senate committee, for example, regarded section 455(a) as a tool for disqualifying a judge for a close personal relationship not covered by section 455(b)(5), which requires disqualification in cases involving relatives up to the third degree of blood relationship. [FN95] The chairman of the ABA committee also regarded the general provision as a means for disqualifying judges for actual bias, and noted ***710** that there was no need for 'fixed opinion' language in section 455(b)(3) because a judge who had expressed an opinion on the merits of a controversy would be disqualified under 455(a). [FN96] These examples indicate that section 455(a) was directed toward actual bias as well as toward the appearance of bias.

Section 455(b) also serves this dual function. Some of the provisions in section 455(b) are clearly directed at promoting the appearance of impartiality rather than protecting parties from actual bias. For example, under section 455(b) a judge is disqualified if she has any financial interest in the case, no matter how small, without the possibility of waiver. [FN97] Concerns with both due process and the preservation of confidence in the judicial system thus permeate the entirety of section 455.

The Supreme Court's analysis of the due process right to an impartial judge provides yet another reason for rejecting an interpretation of the disqualification statutes that conditions review on a finding of actual bias. The due process criteria for judicial disqualification, as delineated by the Supreme Court, [FN98] is not as extensive as the federal statutory requirements mandating disqualification. The Court has focused on disqualification for interest, [FN99] leaving open the question whether a bias charge implicates due process. [FN100] Yet the Court has indicated that where due process requires disqualification, it is concerned with the appearance of justice.

***711** The Court's recent decision in Aetna Life Insurance Co. v. Lavoie [FN101] illustrates its approach to the due process implications of judicial bias. In Lavoie, an insurance company charged that its due process rights were violated because the chief judge on the state appellate court panel was suing other insurance companies on issues similar to those in the Lavoie case and because the other judges on the panel were class plaintiffs in one of the suits. [FN102] The Court found that due process required disqualification of the chief judge on the basis of interest because his decision in Lavoie could enhance the status of a case he had filed in a lower court. [FN103]

The Supreme Court declined to find due process violations based on other grounds of personal bias and interest alleged by the appellants. [FN104] Noting that the right to due process does not extend so far as to require disqualification under the fourteenth amendment whenever it is required under statute, the Court held that 'only in the most extreme of cases would disqualification . . . be constitutionally required' on the basis of bias or prejudice. [FN105] The Court also held that the Constitution does not require disqualification for only a slight pecuniary interest. [FN106]

Although the Lavoie Court held that the due process right to disqualification does not extend to all the circumstances in which Congress has required disqualification, the Court did not tie due process disqualification to a showing of actual fairness. Instead, the Court reiterated the position that due process requires disqualification on the basis of the appearance of partiality, stating:

> We made clear that we are not required to decide whether in fact Justice Emery was influenced, but only

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> whether sitting on the case . . . 'would offer a possible temptation . . . to the average [judge] . . . [to] lead him not to hold the balance nice, clear, and true.' The Due Process Clause 'may sometimes bar trial judges who have no actual bias and who would do their very best to weigh the scales of justice equally between contending parties. But to perform its high function in the best way, 'justice must satisfy the appearance of justice." [FN107]

Thus, the Supreme Court established that whether the due process right to an ***712** impartial judge requires disqualification depends on reasonable inferences from facts that raise the possibility of bias, and not a finding of actual bias.

In instituting the objective standard, Congress made a similar choice regarding the extent of inquiry into bias. Investigation into the state of mind of a judge under the objective standard stops at the point where a reasonable inference of bias or prejudice can be made. This limitation of the inquiry permits, and indeed requires, higher courts to consider disqualification without establishing whether a party actually suffered a violation of the right to an independent adjudicator. Thus the restrictions on the appeal of section 455(a) imposed by the Seventh Circuit, [FN108] a court which refuses post-trial review unless actual bias is involved, are not justified.

B. Reasonable Grounds for Disqualification

1. Judicially-Created Requirements for Disqualification for Bias or Prejudice

The most significant way in which courts have limited the availability of disqualification is by placing restrictions on the types of evidence that can be considered in support of disqualification. Courts require that evidence of bias or prejudice have an extrajudicial source and refuse to consider disqualification for opinions on the law. [FN109] Some courts, however, have interpreted the requirement of 'personal' bias to preclude disqualification on grounds of bias toward an attorney. [FN110] The requirement of 'personal' prejudice is also used to refuse disqualification on the basis of general background and experience. [FN111]

These restrictions originally developed through courts' interpretations of 28 U.S.C. § 144. [FN112] The question whether the judicial gloss on section 144 should apply to 28 U.S.C. § 455 [FN113] was answered in the affirmative soon after section 455 was revised. In Davis v. Board of School Commissioners, [FN114] the United States Court of Appeals for the Fifth Circuit found 'no suggestion in the legislative history that [section 144] decisions were being overruled or in any way eroded.' [FN115] The court concluded that it should 'give [sections] 144 and 455 the same meaning legally . . . whether for purposes of bias and prejudice or when the impartiality of the judge might reasonably be questioned.' [FN116] Most courts agree ***713** that the judicial interpretation of section 144 applies fully to section 455. [FN117] In effect, these courts are finding that the judicial gloss on bias and prejudice defines the grounds upon which it is reasonable to question a judge's impartiality. [FN118]

Court-made restrictions developed under section 144 and carried over to disqualification under section 455 in part reflect the logic of the judicial decision-making process and promote efficiency. [FN119] The restrictions may, however, protect the efficiency of the system at the expense of fairness and public confidence in the judiciary. Unfortunately, the presumption that judges are impartial results in restrictions on evidence and the imposition of a heavy burden on a movant. [FN120] To surmount this presumption, a litigant generally must show clear evidence of personal bias. [FN121] Occasionally, courts have based disqualification on evidence of a level of emotional involvement that indicates 'pervasive prejudice.' [FN122] This heavy burden on the movant however, may not further the goals of disqualification law. [FN123]

***714** a. The extrajudicial source requirement

A fundamental principle of the judicially-created standards for disqualifying judges for bias and prejudice is that the evidence of bias must come from an extrajudicial source. Evidence of prejudice or bias that arises from or can

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be linked to a judicial source, such as pretrial or trial proceeding or any aspect of case management, is excluded from consideration. [FN124] The Supreme Court stated this requirement in United States v. Grinnell: [FN125] 'The alleged bias and prejudice to be disqualifying must stem from an extrajudicial source and result in an opinion on the merits on some basis other than what the judge learned from his participation in the case.' [FN126]

The extrajudicial source requirement is most frequently applied to reject disqualification on the basis of statements made by a judge in the course of a case. [FN127] Courts also apply the extrajudicial source requirement to reject disqualification based on adverse rulings by a judge, [FN128] whether in the trial of the party bringing the motion [FN129] or in previous trials. [FN130] In criminal trials, the extrajudicial source rule is used to prevent disqualification on the basis of allegations questioning a judge's impartiality merely because the judge, while presiding over a previous hearing, was exposed to or ruled on evidence. [FN131] The extrajudicial ***715** source requirement is also invoked to reject disqualification based on claims of bias resulting from hostile actions of a party or an attorney toward a judge or resulting from the judge's response to such actions. [FN132]

The extrajudicial source requirement protects the judicial system from unreasonable interference with judicial decision-making. If statements of opinion could generally disqualify a judge, adjudicators could be inhibited from carrying out the evaluative tasks required to move cases through the court and to reach decisions. [FN133] Use of the extrajudicial source requirement to avoid disqualification as a result of the provocation of a party or attorney serves to prevent litigants from manipulating the judicial system to their advantage by harrassing judges. [FN134]

Despite the important benefits of the extrajudicial source requirement, it could stand in the way of a fair, impartial trial if it were rigidly applied. An absolute refusal to consider as evidence of bias or prejudice any statement made in a judicial setting in response to information learned in the case gives judges a zone of immunity in which to voice personal prejudices. Courts do not, however, generally invoke the extrajudicial source rule to protect a judge from disqualification who has made statements within the judicial context that present clear evidence of personal bias for, or prejudice against, an individual in the case. ***716** Berger v. United States [FN135] presents a classic example of prejudicial statements made by a judge within the judicial context. In Berger, the judge allegedly delivered an anti-German diatribe in a case involving Germans and German-Americans as defendants. [FN136] Another example of a judicial remark revealing bias is found in Roberts v. Bailar, [FN137] a case which involved an employment discrimination suit against the Postal Service. In response to a motion to dismiss a party who had a supervisory role, [FN138] the district court judge said: 'I know Mr. Graves, and he is an honorable man and I know that he would never intentionally discriminate against anybody.' [FN139] Because the actions of this 'honorable man' were at issue in the discrimination suit, the court of appeals held that 'it is clear that a reasonable person would question the impartiality of the District Judge.' [FN140]

The statement at issue in a disqualification motion may not, however, clearly reveal personal bias or prejudice evidenced through an extrajudicial source, but rather may suggest that a bias toward or prejudice against a party has developed over the course of the proceeding or a prior proceeding. Disqualifying a judge in these circumstances requires making an exception to the extrajudicial source rule when a judge's statement or action reveal that he or she has not or is not likely to put aside personal feelings in conducting the trial or passing judgment. The United States Court of Appeals for the Fifth Circuit suggested the possibility of a 'pervasive prejudice' exception in Davis v. Board of School Commissioners [FN141] and applied this exception in United States v. Holland. [FN142] In Holland, a defendant sought disqualification of a district court judge after gaining a new trial on appeal because the judge stated that the defendant had 'broker faith' with the court by appealing and intended to increase the defendant's sentence. [FN143] The appellate court held that the district judge's statement showed pervasive prejudice and thereby satisfied the reasonable person standard for disqualification. [FN144]

In Nicodemus v. Chrysler Corp., [FN145] the Sixth Circuit Court of Appeals disqualified a judge for bias on the basis of his 'vilification' of the defendant in an employment discrimination suit. [FN146] The court indicated that the development of ***717** some degree of bias over the course of court proceedings is a normal part of the judicial process, [FN147] but declared that "if . . . a judge's bias appears to have become overpowering, we think it disqualifies him." [FN148]

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In a situation in which the judge was directly or deliberately provoked by a participant in the case, an emotional response by a judge generally will not disqualify her. [FN149] Nevertheless, even in circumstances in which the judge has been deliberately provoked, an extreme reaction to a party or attorney may necessitate disqualification. [FN150] The appropriate focus under section 455(a) is not whether the judge's statement springs from an extrajudicial source but instead whether the judge's statement or action would lead a reasonable person to question whether the judge would remain impartial.

b. Opinion on law or policy

A second fundamental principle of disqualification law articulated by the courts is that judges cannot be disqualified for their knowledge of, or opinions on, the legal issues in a case. [FN151] The policy concerns underlying this rule are ***718** clear: disqualification on grounds of previously developed legal opinion would wreak havoc within the judicial system. As the United States Court of Appeals for the Third Circuit recently observed: 'If [j]udges could be disqualified because their background in the practice of law gave them knowledge of the legal issues which might be presented in cases coming before them, then only the least-informed and worse-prepared lawyers could be appointed to the bench.' [FN152]

Although the judicially-created rule against considering disqualifying judges on the basis of their legal knowledge is a sound one, application of the rule may be problematic when a judge has been personally involved in instituting a particular policy or when a judge has emphatically expressed support for, or opposition to, a policy position. The best-known case involving the issue of disqualification of a judge for his involvement in instituting a policy is Laird v. Tatum, [FN153] a case in which the plaintiffs challenged army surveillance of anti-war protestors. [FN154] Plaintiffs moved to disqualify Justice Rehnquist, who had cast the deciding vote in a five to four decision dismissing the case, [FN155] on the grounds that he had been involved in defending the surveillance program before a Senate committee as assistant attorney general in the Nixon administration. [FN156] Justice Rehnquist determined that he was not obliged to disqualify himself because he 'did not have even an advisory role in the conduct of the case of Laird v. Tatum.' [FN157] He also declined to disqualify himself through an exercise of discretion, reasoning that opinions on the law and policy were necessary and inevitable, [FN158] and that having publicly expressed these opinions was not sufficient grounds for disqualification. [FN159]

***719** In its revision of section 455, Congress included a specific provision, section 455(b)(3), [FN160] to address issues raised in Tatum. [FN161] Section 544(b)(3) does not, however, clearly require disqualification where a judge is ruling on the applicability or constitutionality of laws or executive policies that he had a significant hand in shaping. Section 455(b)(3), on its face, seems to be applicable only in those cases in which a judge had been involved in, or expressed an opinion about, a particular case. Disqualification in circumstances like those presented in the Tatum case would fall, instead, under the general provision of section 455(a), which requires the court to ask whether the judge's participation in lawmaking raises reasonable doubts concerning his impartiality. It is reasonable to believe that one who has had a significant part in formulating a policy may have difficulty maintaining impartiality when that policy is challenged.

The disqualification issue may also arise when a judge has not played a significant role in formulating policy but rather has expressed an opinion on an issue, either by casting a vote in a legislature, or by publicly expressing an opinion. Courts have generally refused to disqualify judges in these circumstances. [FN162] Nevertheless, evidence of strongly held opinions can raise reasonable doubts about a judge's impartiality.

In Southern Pacific Communications v. American Telephone & Telegraph Co., [FN163] the United States Court of Appeals for the District of Columbia considered the issue of disqualification based on emphatic policy statements in post-trial review of an antitrust case against American Telephone & Telegraph Co. ('AT&T'). The district court judge, in his memorandum opinion, [FN164] forcibly stated his belief that the public interest was better served by an AT&T monopoly rather than by competition in the telecommunications industry. [FN165] The court of appeals, noting that views on the law and policy do not ordinarily disqualify a judge, [FN166]

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allowed for the possibility of disqualification if the court prejudged a case. [FN167] The court set forth an 'irrevocably closed mind' test for determining ***720** when a judge's actions overcome the presumption of impartiality. [FN168]

The Southern Pacific Communications 'irrevocably closed mind' test cannot be applied to pretrial disqualification, however. Pretrial application of the test would conflict with the presumption that a judge will maintain an open mind toward a case, and follow precedent faithfully. [FN169] In a section 455(a) pretrial disqualification challenge, this presumption would preclude challenge of a judge's impartiality prior to trial because it would not be possible to prove that an upcoming presentation of an issue would not sway the judge. [FN170] A litigant cannot make a pretrail showing of an 'irrevocably closed' mind sufficient to overcome the presumption when such a showing depends on evidence of bias in the proceedings. [FN171]

Although in general a judge may not be disqualified for an opinion on the law, a judge may be disqualified for holding a fixed opinion regarding sentencing. [FN172] This exception was established in United States v. Thompson, [FN173] the case in which the defendants had allegedly violated the Selective Service Act. [FN174] The district court judge, in a previous case, had announced that it was his policy to sentence all Selective Service Act violators to at least thirty months in jail. [FN175] ***721** The appellate court determined that this allegation provided grounds for disqualification because it 'was not an allegation of judicial bias in favor of a particular legal principle,' but rather of personal bias 'directed against the appellant as a member of a class.' [FN176] The court also noted, however, that a fixed policy as to sentencing was inconsistent with the trial judge's authorized discretion to tailor sentences appropriately. [FN177]

The Thompson court's consideration of the judge's violation of his official duties suggests a framework for a narrow exception permitting disqualification for opinions on the law or public policy. Courts could adopt the rule that while policy statements should not generally provide grounds for disqualification, an exception will be made when a statement or action would lead a reasonable person to conclude that the judge is predisposed to violating his or her oath or ignoring a mandate. [FN178] Such a rule would not interfere with the present practice of refusing disqualification when the judge's statement expresses an enthusiastic commitment to enforce the law, [FN179] or when a judge previously voted in favor of a law applicable in the case. [FN180] Simple disagreement with existing law would also not disqualify. [FN181] Under the proposed exception, however, the presumption of impartiality could be overcome if a judge's action provided evidence of intense disagreement with a particular policy or law. [FN182] The critical issue would be whether the judge could reasonably be expected to put aside his or her personal feelings, rather than allow them to dominate the decision-making process. [FN183]

c. Bias or prejudice toward an attorney

Some courts have required that judicial bias be directed toward the party as an individual, rather than toward that party's attorney, before disqualifying a ***722** judge. [FN184] Under section 455(a), however, bias or antipathy directed at counsel may justify disqualification, but only if this bias or prejudice could affect the outcome of the case to the detriment of a party. [FN185] As the United States Court of Appeals for the Tenth Circuit noted in United States v. Ritter, [FN186] 'if a judge is biased in favor of an attorney, his impartiality might reasonably be questioned in relationship to the party.' [FN187]

Yet, as the Ninth Circuit has noted, when a judge is charged with prejudice against an attorney, the court must take into account tensions between judge and attorney inherent in the adversarial system. [FN188] A disqualification motion based on bias for or prejudice against an attorney thus should be evaluated in context, like other charges of prejudice arising from a judge's statements or actions within the judicial process.

d. General background and experience

Reviewing courts also refuse to disqualify judges on the basis of their general background, education, and experience. [FN189] In Blank v. Sullivan & Cromwell, [FN190] a sex discrimination case against a law firm, the

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defendant sought to disqualify the judge because she was female and as a lawyer had worked on behalf of minorities who had suffered from discrimination. [FN191] The Blank court refused to disqualify, reasoning that if background, race, or sex were in themselves grounds for removal, 'no judge on this court could hear this case, or many others, by virtue of the fact that all of them were attorneys, of a sex, [and] often with distinguished law firm or public service backgrounds.' [FN192]

***723** Rejection of recusal for general background or experience is sensible because evidence of general associations does not provide a reasonable basis for an inference of bias. [FN193] Courts must, however, carefully distinguish between general evidence of background or associations and specific evidence that may provide a basis for disqualification under section 455(a) if an interest or relationship is not specified under section 455(b). [FN194]

2. Grounds for Disqualification Under Section 455(a) Other Than Bias or Prejudice

Disqualification under section 455(a) is not limited to circumstances where bias or prejudice is explicitly alleged; section 455(a) also applies when an interest or relationship, not among those defined by section 455(b), raises doubt about a judge's impartiality. [FN195] It is evident from the record of the Senate committee hearing on the proposed revision of section 455 that Congress envisioned the use of section 455(a) as a tool for disqualification on grounds not specified in section 455(b). [FN196]

Recognizing the scope of the general provisions, courts have made use of section 455(a) to disqualify judges for interests or relationships not covered by section 455(b). [FN197] Several courts have used section 455(a) as their framework for examining disqualification motions that allege that a judge's law clerk or former law clerk had a role or an interest in a case. [FN198] The United States Court of Appeals for the Third Circuit has held that judges are required under section 455(a) to disqualify themselves from criminal actions if they have a substantial interest in the victim of the crime. [FN199] The Fifth Circuit, in Potashnick v. Port ***724** City Construction Co., [FN200] relied on section 455(a) to disqualify a judge who had extensive business dealings with the plaintiff's attorney. [FN201] More recently, the Fifth Circuit used section 455(a) in Health Services Acquisition Corp. v. Liljeberg [FN202] to disqualify a judge who claimed he had no knowledge of information that, if known, would have disqualified him under section 455(b)(4). [FN203]

In each of these cases, the respective appellate court determined that a relationship or interest in itself raised questions regarding impartiality. The courts did not evaluate the extent of the relationship or interest to determine whether the judge in each case was actually biased. Rather, the courts disqualified due to the appearance of bias. [FN204]

Casting disqualification questions in terms of relationships or interests, instead of in terms of bias, has several advantages. Stating the disqualification motion in terms of a questionable relationship can bring into clearer focus the grounds for objecting to the participation of a particular judge. [FN205] In addition, relationships and interest are easier for courts to ascertain because the evidence is more concrete and accessible. Such decisions are also easier to review, since the court can consider, as a matter of law, whether a particular interest or relationship should be added to the list of those that disqualify. [FN206] Furthermore, resting the need for disqualification on the existence of a relationship is less personal and may be easier for a judge to view objectively than a direct charge of bias.

Nevertheless, litigants and courts tend to treat any relationship or interest not specifically enumerated in Section 455(b) as presenting a question of disqualification for bias or prejudice, requiring the more difficult showing of personal prejudice, rather than considering the relationship under section 455(a). The opinion issued by the Fifth Circuit in United States v. Harrelson [FN207] provides an ***725** example of this tendency. The Harrelson defendants were convicted of murder and conspiracy to murder a federal judge. [FN208] Pursuant to section 455(a), the defendants had sought to disqualify the trial judge, who had known and worked with the murder victim for eight or nine years, served as an honorary pallbearer at his funeral, and eulogized him at several

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memorial ceremonies. [FN209] The court analyzed section 455(a) as requiring disqualification on the basis of conduct that shows personal prejudice, insisting that 'recusal is not warranted absent specific instances of conduct indicating prejudice against a defendant.' [FN210] Because such evidence was lacking, the court held that disqualification was not required. [FN211]

The Harrelson court then considered the question of relationship briefly and superficially. [FN212] The court reasoned that a trial judge in this position may harbor hostility toward the actual killers but would presume the innocence of persons pleading not guilty. [FN213] The court did not consider the possible impact of this hostility if the judge reached a conclusion regarding guilt before the end of the trial or its possible impact upon sentencing. [FN214] The court concluded that absent a stronger showing of personal prejudice, a reasonable person would not presume that the 'careful and seasoned trial judge' was biased. [FN215] By requiring a showing of personal prejudice, [FN216] the court lost sight of the objective 'appearance of bias' standard established in section 455(a) as applied to questions of disqualifying relationship or interest.

Other courts have given questions involving a relationship equally short shrift. For example, in United States v. Balistrieri, [FN217] disqualification was sought ont he grounds that the judge, when he was Wisconsin Attorney General, identified the defendant as the head of an organized crime family and targeted the defendant's family business for investigation in his efforts against organized crime. [FN218] The court denied disqualification on the grounds that there was no showing of personal animus [FN219] and did not ask whether a reasonable person would consider the relationship of the judge to the defendant one which called into doubt the impartiality of the judge. [FN220]

***726** The tendency of courts to focus on personal prejudice suggests that a subjective element remains in disqualification decisions under section 455(a) despite the congressional emphasis on an objective standard. The next section will examine the disqualification decision-making process and consider means for achieving greater objectivity in disqualification under section 455(a).

III. DISQUALIFICATION PROCEDURE

A. Disqualification Decision-Making

Objective disqualification can be promoted by clarifying the process of evaluating evidence for disqualification. The inherently subjective nature of evidence of personal bias and prejudice may make objective evaluation difficult. [FN221] Yet even when disqualification is based on bias or prejudice, courts are required by Congress to apply the objective standard of section 455(a). [FN222]

The decision-making process followed when disqualification is based on an interest or relationship defined under section 455(b) [FN223] is simple to describe and provides a framework for a more objective approach to disqualification under section 455(a). In deciding whether to disqualify for interest or relationship, the first question a court poses is: does the interest or relationship exist? If it does, the court must arrive at an accurate description of the relationship and ask: does the judge's interest or relationship fall within those specified under section 455(b)? If so, disqualification is automatic. [FN224] The statute imposes the presumption that the particular interest or relationship would reasonably result in bias. [FN225]

If the interest or relationship is not one specified under section 455(b), the next question posed is whether this interest or relationship reasonably raises questions regarding a judge's impartiality. [FN226] Once the factual determination is ***727** made regarding the existence of an interest or relationship, the question whether it provides reasonable grounds for disqualification is one an appellate court can determine as a matter of law. [FN227]

In cases seeking disqualification on the basis of personal bias or prejudice, the judge's statements and other expressive actions provide the evidence for disqualification. [FN228] To make an objective assessment of this evidence, the court must first test its accuracy, and question whether the event or statement occurred as reported.

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Once the court has obtained an accurate description of the expressive act that may reveal bias, that evidence must be evaluated using the reasonable person standard to determine whether the expressive acts reasonably raise doubts regarding the judge's impartiality. [FN229] Under the objective standard, it is inappropriate for the court to inquire further and attempt to determine the judge's actual state of mind. The court is limited to assessing outward manifestations and to making a reasonable inference as to whether the typical judge would be biased under those circumstances. [FN230]

The task of applying the objective standard to the facts grants the judge a degree of discretion in disqualification decisions under section 455(a) that is not present in section 455(b) decisions. The scope of that discretion is limited, however, because Congress established a low threshold when it eliminated the duty to sit. [FN231] Judges are required to recuse themselves if they perceive any grounds for disqualification. [FN232] The discretion of district court judges can be limited further by the courts of appeals if they respond to disqualification cases by establishing clearer guidelines for disqualification. [FN233]

***728** B. Evaluation by the Challenged District Court Judge

Federal law provides that the decision-making process described above be carried out by the judge who is under challenge. Under section 144, which provides for disqualification upon filing of a sufficient affidavit, [FN234] the challenged judge is charged with determining whether the affidavit is legally sufficient. [FN235] Although the judge is required to assume the truth of the allegations and the good faith of the attorney regardless of any knowledge to the contrary, [FN236] the judge exercises significant power over disqualification. The requirement of convincing evidence of bias, [FN237] and the restrictions on disqualification evidence such as the extrajudicial source rule, [FN238] give the challenged judge the responsibility of making an extensive evaluation of the charges. [FN239]

Under section 455, judges have more latitude in reaching the decision whether to disqualify themselves. Judges are not required to accept the veracity of the factual averments in a motion, but rather are free to make credibility determinations, weigh the evidence, and contradict it with facts drawn from their own personal knowledge. [FN240]

Giving the challenged judge this role in the disqualification process has the advantage of allowing the judge with the best knowledge of the issue to resolve it speedily. But when the judge denies disqualification, questions regarding that judge's impartiality are compounded rather than settled. Moreover, the appearance of impartiality is not advanced when a challenged judge proceeds to try a case and there has been no outside assessment of the challenge to that judge's impartiality. [FN241]

***729** C. Other Means for Determining Disqualification

Commentators have proposed several ways of changing or supplementing disqualification procedures to better ensure an impartial adjudicator. One proposed alternative to the current disqualification procedure is to eliminate judicial decision-making from the process by instituting the peremptory challenge of judges. [FN242] reliance on peremptory challenge, however, may lead to judge-shopping [FN243] and inefficiency. [FN244] Furthermore, the introduction of a peremptory challenge would not actually address the problem of ensuring impartial judges. The proposals limit litigants to one use of a peremptory challenge. [FN245] Litigants could face a biased judge after reassignment and the need for a statute disqualifying judges for cause would remain, as would the problems of achieving disqualification on an objective standard under such a statute.

The other two proposed alternatives, which would bring judges other than the challenged judge into the disqualification process, deserve more extensive consideration. One proposal is to transfer the decision to another judge at the district court level. A second alternative is to allow full and immediate appellate review of denials of disqualification.

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1. Transfer to Another District Judge

Commentators have recommended that independent adjudication of disqualification motions be assured by requiring that a district court judge presented with a disqualification motion transfer the motion to another judge for decision. [FN246] Such a transfer would, according to commentators, address the problem presented by having judges decide their own cases, provide a more disinterested forum, and thus promote the appearance of impartiality. [FN247] The major objection commentators have leveled against this proposal is that transfer of ***730** the disqualification motion to another judge for a hearing, or for review of affidavits, [FN248] would delay litigation and impose an administrative burden. [FN249] Those advocating this alternative argue that an independent review of disqualification is worth the delay and burden on the courts. [FN250]

2. Appellate Review

Another means for insuring independent assessment of disqualification decisions is to afford litigants immediate and comprehensive review of disqualification denials. Immediate appellate review would clearly further the goals of judicial disqualification. Without interlocutory review, trials proceed before judges whose impartiality is in question, thereby imposing upon litigants a possibly unfair trial and undermining the public perception of the impartiality of judges. [FN251]

Nevertheless, routine interlocutory consideration of disqualification would impose a burden on the courts. Timely appeal may, however, reduce the burden imposed on the judicial system when a new trial is necessitated following reversal based on disqualification. [FN252] Moreover, resolution of a disqualification issue at pretrial is less complex than resolution of the disqualification question as part of a completed case. In post-trial review, a new trial may be required even though everything but the disqualification issue appears to have been correctly decided. [FN253] In this position, a court may be reluctant to apply the liberal standards instituted by Congress which address the disqualification question.

Unfortunately, timely review of disqualification denials is impeded by statutory limitations on interlocutory review. Disqualification motions are usually raised and decided before the trial. [FN254] A final decision on the merits of a case is ***731** generally required, however, before an issue in a case can be reviewed on appeal. [FN255]

Review under a writ of mandamus, however, provides a vehicle by which the courts may hear disqualification denials. [FN256] Mandamus is a writ used to ***732** command an official to perform a specific act that arises from a public duty, [FN257] or to confine a court to lawful exercise of its prescribed jurisdiction. [FN258] Issuance of the writ is traditionally limited to extraordinary circumstances, [FN259] however, and several conditions governing mandamus limit its use for review of disqualification denials and the comprehensiveness of review under the writ.

One limitation on use of the writ of mandamus is that the writ can be used only to 'compel an officer to perform a purely ministerial duty.' [FN260] A writ of mandamus may be issued to confine judges to their jurisdictional powers or to compel them to exercise their judicial authority, but it cannot be used to compel action within judicial discretion. [FN261] Mandamus may be issued, however, where the discretionary duty is limited and the official has abused that discretion by transgressing those limits. [FN262]

'Abuse of discretion' is the standard of review that is generally applied to section 455 motions on appeal. [FN263] Thus, this requirement of mandamus raises questions, which are also present in post-trial review of disqualification denials, regarding the amount of discretion judges actually have over disqualification and what constitutes abuse of this discretion. If the judge's discretion is limited, review is possible under a writ of mandamus and more comprehensive at any stage.

Establishment of abuse of discretion as the standard of review for section 455 decisions occurred prior to the

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1974 decision when disqualification was completely discretionary. [FN264] When Congress revised section 455, it made disqualification mandatory, rather than discretionary, when a reasonable person would question the judge's impartiality. [FN265] Yet the House of Representatives' commentary on the revised bill suggested that section 455 decisions would continue to be reviewed under the abuse of discretion standard. [FN266] The House report ***733** stated that '[t]he issue of disqualification is a sensitive question of assessing all the facts and circumstances in order to determine whether the failure to disqualify was an abuse of sound judicial discretion.' [FN267]

On the basis of the House report, appellate courts generally have applied the abuse of discretion standard to section 455 questions with little consideration of what discretion the district court should exercise. [FN268] Occasionally, appellate courts have displayed discomfort with broad discretion by focusing on the substantive issue in a case, thoroughly evaluating the evidence, independently assessing reasonableness, and stating their conclusions without any reference to abuse of discretion. [FN269]

Recently, the Seventh Circuit directly questioned the abuse of discretion standard in United States v. Balistrieri, [FN270] and rejected it as an inappropriate standard for appellate evaluation of section 455(b)(1) decisions. [FN271] The court held that review of a disqualification denial should not be deferential because a disqualification motion 'puts into issue the integrity of the court's judgment' and places adjudicators in the role of judges of their own cause. [FN272]

The Balistrieri court's position has appeal because it addresses the most troublesome aspect of the disqualification process, the requirement that a judge under attack make an 'objective' assessment of his personal, emotional involvement. In addition, the Balistrieri court's position rests on the argument frequently used to support mandamus jurisdiction--the responsibility of the courts of appeals to supervise and maintain the integrity of the judicial system. [FN273] The court did not, however, address the fact that plenary review of disqualification is in conflict with the congressional commentary on the standard of review, [FN274] and contrary to the general practice of the courts. [FN275]

Although the position taken by the Balistrieri court is extreme, consideration of the congressional statement in context suggests that appellate courts should not be wholly deferential to district court judges who have denied a disqualification motion. The House Report called on appellate courts to assess 'all the facts and circumstances' of a disqualification issue at the same time that it ***734** referred to 'sound judicial discretion,' [FN276] thus suggesting that the court's review should be comprehensive. Furthermore, Congress severely constricted judicial discretion over disqualification in revising section 455. This is evidenced by the fact that there is no discretion if the circumstances of a case fit within one of the categories in section 455(b), which mandates disqualification without exception. [FN277] Although judges have some discretion in their evaluation of the evidence under the objective standard of section 455(a), their evaluation is limited by the low threshold of proof set by Congress and by guidelines set by the appellate courts. [FN278] Moreover, when reasonable grounds for disqualification exist disqualification is mandatory. [FN279] The discretion of the district court is thus narrowly circumscribed and subject to the supervision of the courts of appeals.

Other limitations on issuance of the writ of mandamus restrict its availability. One limitation is that the writ is generally not available when appeal from final judgment provides an adequate remedy. [FN280] The Fifth Circuit has denied the writ on the grounds that appeal provided an adequate remedy for failure to disqualify. [FN281] The majority of courts have held, however, that review of disqualification denials prior to final judgment is critical to the judicial system, if not to the litigant. [FN282]

A more significant barrier to obtaining disqualification by means of a writ of mandamus is that litigants are required to show that their right to issuance of the writ is 'clear and indisputable.' [FN283] It is possible to interpret this requirement as necessitating no more than a finding of abuse of discretion. [FN284] But the ***735** need to show a clear and indisputable right has also been interpreted as imposing a higher standard of review. [FN285] Following disqualification denials, courts of appeals generally require a non-frivolous claim for

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disqualification [FN286] and require that bias be 'clearly and indisputably' established. [FN287]

The limited scope of discretion in disqualification decisions and the courts' general interpretation of mandamus requirements suggest that limitations on mandamus do not preclude interlocutory review of disqualification motions in federal courts. Courts have, in fact, advocated liberal interpretation of their powers of review under the writ in disqualification matters as a measure essential to preserving the integrity of the court. [FN288] Actual disqualification by means of the writ is subject to the clear and indisputable right requirement, however. Thus the writ can be used to correct clearly wrongful refusals but it may not be available for routine review. As a result, mandamus review cannot be relied on to ensure the participation of an adjudicator other than the challenged judge in the disqualification decision.

CONCLUSION

The goals of fairness and public confidence in the judiciary are not fully met by current disqualification practices. Mandamus provides a means for courts of appeals to supervise and set standards for clear abuse of discretion, but it does not provide for the routine involvement of an independent adjudicator in the disqualification process. [FN289] To make objective disqualification more meaningful, Congress should act either to amend section 455 to provide for transfer of the disqualification motion to another adjudicator at the district court level [FN290] or provide for immediate and comprehensive appellate review of disqualification denials without the restrictions imposed on review under the writ of mandamus. [FN291]

***736** In addition to congressional action to ensure independent adjudication of disqualification issues, realization of the goals of judicial disqualification require the commitment of the courts. Congress struck a balance when it revised section 455 and decided that, despite the burdens disqualification imposed, it would be mandated where a judge's impartiality might reasonably be questioned. [FN292] Congress has appropriately left to the courts the responsibility of interpreting this standard. The courts, however, have not always held fast to the objectives Congress established. [FN293] Instead, courts have avoided the burden of disqualification by failing to focus on the congressionally mandated objective standard, and by showing deference at the appellate level to the decisions of the challenged judges. One circuit has gone so far as to impose the requirement of a high standard of proof of bias as a prerequisite to post-trial review. [FN294]

To establish the proper balance, courts of appeals should reexamine the restrictions they have placed on disqualification. As supervisors of the district courts, they should use the available review procedures to set forth more explicit guidelines for disqualification based on an objective standard and thus hold district court judges to the appropriate high level of accountability.

FN1. Ward v. City of Monroeville, 409 U.S. 57, 61-62 (1972). See also Marshall v. Jerrico, Inc., 446 U.S. 238, 243 (1980) ('powerful' constitutional interest in fair adjudicative procedure); Redish & Marshall, Adjudicatory Independence and the Values of Procedural Due Process, 95 YALE L.J. 455, 457 (1986) (independent adjudicator necessary to satisfy due process requirements).

FN2. See Judicial Disqualification: Hearing on S. 1064 Before Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary, 93d Cong., 1st Sess. 1, 75 (1971 and 1973) [hereinafter Senate Hearing] (statement of Senator Burdick) (disqualification ensures that judicial decision is not tainted with partiality and thus 'enhances public confidence in the judicial system').

FN3. The first federal disqualification statute disqualified judges from cases in which the judge was 'concerned in interest,' or had been of counsel for either party. Act of May 8, 1792, ch. 36, § 11, 1 Stat. 278 (1872) (amended and recodified 1911). 28 U.S.C. § 455(b) (1982) requires judges to disqualify themselves on several specified grounds, including financial interest, personal or professional relationships with persons involved in the litigation, or prior involvement in the litigation. See infra note 12 for the text of § 455(b). In addition, federal law disqualifies judges in circumstances where a reasonable person would question a judge's impartiality, 28 U.S.C. § 455(a), and specifically

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disqualifies a judge for bias or prejudice. 28 U.S.C. §§ 144 & 455(b)(1); see infra note 35 for the text of § 144, and infra note 12 for the text of § 455.

FN4. Senate Hearing, supra note 2, at 74 (statement of Senator Burdick); H.R. REP. NO. 1453, 93d Cong., 2d Sess. 1, reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 6351, 6354 [hereinafter House Report].

FN5. 28 U.S.C. § 455(a) (1982). See infra note 12 for the text of § 455(a).

FN6. See infra notes 26-30 and accompanying text for a discussion of the congressional intent behind the revision of § 455.

FN7. See infra notes 83-108 and accompanying text for a discussion of the standards of proof of bias under §§ 455(a), 455(b)(1) and 144.

FN8. See infra notes 109-94 and accompanying text for a discussion of the judicially-created substantive rules for disqualification.

FN9. See infra notes 23-25, 228-32 and accompanying text for a discussion of disqualification procedures.

FN10. See infra notes 51-88 and accompanying text for a discussion of the availability and standards of review on appeal.

FN11. 28 U.S.C. §§ 144, 455 (1982). Appellate courts as well as district courts are subject to § 455, while § 144 applies only to district courts. The only other federal disqualification statute applies to appellate courts and provides that '[n]o judge shall hear or determine an appeal from the decision of a case or issue tried by him.' 28 U.S.C. § 47 (1982).

FN12. 28 U.S.C. § 455 (1982) states:

> (a) Any justice, judge, or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.
>
> (b) He shall also disqualify himself in the following circumstances:
>
> > (1) Where he has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;
> >
> > (2) Where in private practice he served as lawyer in the matter in controversy, or a lawyer with whom he previously practiced law served during such association as a lawyer concerning the matter, or the judge or such lawyer has been a material witness concerning it;
> >
> > (3) Where he has served in governmental employment and in such capacity participated as counsel, adviser or material witness concerning the proceeding or expressed an opinion concerning the merits of the particular case in controversy;
> >
> > (4) He knows that he, individually or as a fiduciary, or his spouse or minor child residing in his household, has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding;
> >
> > (5) He or his spouse, or a person within the third degree of relationship to either of them, or the spouse of such a person:

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(i) Is a party to the proceeding, or an officer, director, or trustee of a party;

(ii) Is acting as a lawyer in the proceeding;

(iii) Is know by the judge to have an interest that could be substantially affected by the outcome of the proceeding;

(iv) Is to the judge's knowledge likely to be a material witness in the proceeding.

(c) A judge should inform himself about his personal and fiduciary financial interests, and make a reasonable effort to inform himself about the personal financial interest of his spouse and minor children residing in his household.

(d) For the purposes of this section the following words or phrases shall have the meaning indicated:

(1) 'proceeding' includes pretrial, trial, appellate review, or other stages of litigation;

(2) the degree of relationship is calculated according to the civil law system;

(3) 'fiduciary' includes such relationships as executor, administrator, trustee, and guardian;

(4) 'financial interest' means ownership of a legal or equitable interest, however small, or a relationship as director, adviser, or other active participant in the affairs of a party, except that:

(i) Ownership in a mutual or common investment fund that holds securities is not a 'financial interest' in such securities unless the judge participates in the management of the fund;

(ii) An office in an educational, religious, charitable, fraternal, or civil organization is not a 'financial interest' in securities held by the organization;

(iii) The proprietary interest of a policyholder in a mutual insurance company, of a depositor in a mutual savings association, or a similar proprietary interest, is a 'financial interest' in the organization only if the outcome of the proceeding could substantially affect the value of the interest;

(iv) Ownership of government securities is a 'financial interest' in the issuer only if the outcome of the proceeding could substantially affect the value of the securities.

(e) No justice, judge, or magistrate shall accept from the parties to the proceeding a waiver of any ground for disqualification enumerated in subsection (b). Where the ground for disqualification arises only under subsection (a), waiver may be accepted provided it is preceded by a full disclosure on the record of the basis for disqualification.

FN13. Id. § 455(a).

FN14. Id. § 455(b).

FN15. Id. § 455(b)(4).

FN16. Id. § 455(d)(4).

FN17. Id. § 455(b)(5).

FN18. Id. § 455(b)(2).

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FN19. Id. § 455(b)(3).

FN20. Id. § 455(b)(1).

FN21. Id. § 455(e).

FN22. Id. The waiver provision is an inversion of the waiver provisions of the American Bar Association ('ABA') Code of Judicial Conduct. In the final draft of the ABA Code, waiver of disqualification on grounds of interest or relationship is allowed after full disclosure. CODE OF JUDICIAL CONDUCT Canon 3D (1972). Waiver is not permitted under the general provision that disqualifies the judge whose impartiality is reasonably questioned. Id. The ABA's rule was based on the premise that parties should not be permitted to waive a provision designed to promote public confidence in the judiciary. Senate Hearing, supra note 2, at 109 (Professor Thode, Reporter of the ABA's Special Committee on Standards for Judicial Conduct). The ABA allowed waiver where public confidence in the judiciary would not be affected, and safeguarded the parties by requiring that the waiver be made in writing, rather than orally in the presence of the judge. Id. The Senate framers, on the other hand, rejected any waiver of disqualification based on § 455(b) grounds, but allowed waiver of § 455(a) disqualification on the rationale that a judge should be permitted to discuss with the attorneys involved in a case whether the objective standard required disqualification. Id. at 112 (Mr. Westphal, chief counsel to the Senate Committee on the Judiciary).

FN23. 28 U.S.C. § 455(a) ('Any judge . . . shall disqualify himself. . . .'); id. § 455(b) ('He shall also disqualify himself. . . .').

FN24. See Roberts v. Bailar, 625 F.2d 125, 128 (6th Cir. 1980) (party need not follow particular procedure under § 455(a); federal judges must observe § 455 guidelines sua sponte).

FN25. Davis v. Board of School Comm'rs, 517 F.2d 1044, 1051 (5th Cir. 1975), cert. denied, 425 U.S. 944 (1976).

FN26. Act of Dec. 5, 1974, Pub. L. No. 93-512, § 1, 88 Stat. 1609 (codified as amended at 28 U.S.C. § 455 (1982)).

FN27. Senate Hearing, supra note 2, at 74 (statement of Senator Burdick); House Report, supra note 4, at 6355. The revisions were also motivated, in part, by a perceived need for clarification of standards that arose from the confirmation hearings for Judge Haynsworth, a Nixon nominee to the Supreme Court who was rejected by the Senate. Senate Hearing, supra note 2, at 10, 25 (statements of Senators Burdick, Bayh, and Hollings).

Congress also acted to coordinate federal law with revisions in the Canon of Judicial Conduct being developed by the American Bar Association. A tentative draft of the proposed ABA revisions was circulated two months prior to the first Senate hearings on the revisions to § 455, and the bill was delayed until the ABA completed its process of revision. Senate Hearing, supra note 2, at 2, 74, 78-79 (statements of Senator Burdick and Judge Traynor). The bill's sponsors wanted to minimize discrepancies between federal disqualification law and ABA standards. Id. at 74 (Senator Burdick).

The bill's sponsors were also motivated by their perception of heightened public standards of impartiality, id. at 10 (statement of Senator Bayh), and noted that the increased number of federal judges gave them the freedom to require stricter standards. Id. at 26 (statement of Senator Hollings).

FN28. The superseded statute read in full:

Any justice or judge of the United States shall disqualify himself in any case in which he was a substantial interest, has been of counsel, is a material witness, or is so related to or connected with any party or his attorney as to render it improper, in his opinion, for him to sit on the trial, appeal, or other proceeding therein.

Act of June 25, 1948, ch. 646, § 455, 62 Stat. 908.

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FN29. 28 U.S.C. § 455(a); see supra note 12 for the text of § 455(a).

FN30. Senate Hearing, supra note 2, at 2, 74 (Senator Burdick); House Report, supra note 4, at 6255. The chairman of the Senate Judiciary Committee described the 'duty to sit' rule as a rule that clouded a judge's judgment on disqualification. Senate Hearing, supra note 2, at 74 (Senator Burdick). The House, however, added the caution that elimination of this rule 'should not be used by judges to avoid sitting on difficult or controversial cases.' House Report, supra note 4, at 6355; see also New York City Hous. Dev. Corp. v. Hart, 796 F.2d 976, 980 (7th Cir. 1986) (judge disqualified himself unnecessarily when his holdings did not constitute § 455(b)(4) financial interest). The court stated: 'A judge may decide close calls in favor of recusal. But there must first be a close call.' Id.

FN31. See supra note 12 for the text of § 455(b)(1); see infra note 35 for the text of § 144.

FN32. Courts have determined that a motion for disqualification under one of the sections--455(a), 455(b)(1), or 144--requires the consideration of disqualification under the other sections as well. See Roberts v. Bailar, 625 F.2d 125, 128 (6th Cir. 1980) (judge has duty to consider disqualification under § 455 when § 144 affidavit does not require disqualification); United States v. Sibla, 624 F.2d 864, 868 (9th Cir. 1980) (judge who declines to grant recusal under § 455 must still consider sufficiency of affidavit under § 144).

Courts have coordinated the statutes procedurally by charting various paths that reach, if necessary, all three provisions. One approach is to begin by evaluating the affidavit under § 144 and to proceed to assessment of the situation under § 455 only if the affidavit is untimely or insufficient. See United States v. Balistrieri, 779 F.2d 1191, 1202 (7th Cir. 1985) (after determining § 144 affidavit legally insufficient, court considered disqualification under § 455(b)(1)), cert. denied, 106 S. Ct. 3284 (1986); Bailar, 625 F.2d at 128 (judge disqualified under § 455(a) although § 144 affidavit was technically insufficient); Sibla, 624 F.2d at 868 (finding that § 144 affidavit is legally insufficient triggers duty to evaluate circumstances under § 455).

Alternatively, judges may begin with § 455(a) and evaluate the § 144 affidavit only if they do not disqualify themselves under § 455. See Sibla, 624 F.2d at 868 (judge who declines to grant recusal under § 455 must still consider the sufficiency of the affidavit under § 144). A judge beginning at § 455(a) would need to consider § 144 only if the allegations of bias where false and thus would not lead a reasonable person to question the judge's impartiality.

FN33. See infra notes 112-18 and accompanying text for a discussion of courts' application of the § 144 judicial gloss to § 455(a).

FN34. Act of March 3, 1911, ch. 231, § 21, 36 Stat. 1090 (amended by Act of June 25, 1948, ch. 646, § 144, 62 Stat. 898) (amendment added the words 'timely and sufficient' to modify 'affidavit').

FN35. 28 U.S.C. § 144 (1982) provides:

> Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding.
>
> The affidavit shall state the facts and the reasons for the belief that bias or prejudice exists, and shall be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, or good cause shall be shown for failure to file it within such time. A party may file only one such affidavit in any case. It shall be accompanied by a certificate of counsel of record stating that it is made in good faith.

FN36. Id.

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FN37. A § 144 affidavit must 'state the facts and reasons for the belief that bias or prejudice exists,' 28 U.S.C. § 144, and must be signed. See Roberts v. Bailar, 625 F.2d 125, 128 (6th Cir. 1980) (court need not consider § 144 motion where party had not signed affidavit). A court may consider only one affidavit filed pursuant to § 144. See United States v. Merkt, 794 F.2d 950, 961 (5th Cir. 1986), cert. denied, 107 S. Ct. 1603 (1987); United States v. Balistrieri, 779 F.2d 1191, 1199 (7th Cir. 1985), cert. denied, 106 S. Ct. 3284 (1986).

Section 144's timeliness provision has been interpreted to require filing of the motion within a reasonable time of discovery of the bias. See United States v. Gigax, 605 F.2d 507, 511 (10th Cir. 1979) (file § 144 motion promptly after facts become known); Smith v. Danyo, 585 F.2d 83, 86 (3d Cir. 1978) (timeliness measured not in absolute and arbitrary way from date of discovery but with consideration of future stages of case).

FN38. See Berger v. United States, 255 U.S. 22, 36 (1921).

FN39. 255 U.S. 22 (1921).

FN40. Id. at 35-36.

FN41. Until the Supreme Court decided Berger, it was possible to interpret § 144 as providing a peremptory challenge. The chief sponsor of the bill indicated that it would function as a form of peremptory challenge of judges, 46 Cong. Rec. 2627 (1911) (statements of Rep. Cullop), and the wording of the original provision would have permitted it to be so used. Prior to amendment it 1948, the word 'sufficient' did not appear as a modifier of 'affidavit.' Act of March 3, 1911, ch. 231, § 21, 36 Stat. 1090. The 1911 version required the judge to transfer the case when 'an affidavit' was filed. Id.

FN42. Berger, 255 U.S. at 36. The Court explained: 'To commit to the judge a decision on the truth of the facts gives chance for the evil against which the section is directed.' Id.

FN43. See infra notes 109-94 for a discussion of judicial rules for disqualification on the basis of personal bias or prejudice.

FN44. 28 U.S.C. § 455(b)(1).

FN45. Compare § 455(b)(2)-(5) with § 455(b)(1).

FN46. See supra note 12 for the text of § 455(b)(1).

FN47. Courts seldom offer a definition of bias or prejudice. The Supreme Court provided a general, but tautological, definition of bias or prejudice in Berger v. United States, describing it as 'a bent of mind that may prevent or impede impartiality of judgment.' 255 U.S. at 33-34. In case law, positive definitions tend to be fact-specific. For example, in Mims v. Shapp, 541 F.2d 415 (3d Cir. 1976), a prisoners' rights suit in which the judge was accused of bias toward state prisoners, the court defined personal bias 'as an attitude toward petitioner that is significantly different from and more particularized than the normal, general feelings of society at large against convicted wrongdoers.' Id. at 417.

FN48. S. 1553, 92d Cong., 1st Sess. (1971), reproduced in Senate Hearing, supra note 2, at 3.

FN49. 28 U.S.C. § 455(b)(1).

FN50. Senate Hearing, supra note 2, at 85. As the chairman of the ABA committee explained, 'There are many things on which it may be good for judges to have fixed opinions, like fixed opinions on freedom under the first amendment, fixed opinions that racial discrimination is invidious, and so on.' Id.

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 318

FN51. See supra note 35 for the text of § 144. The ABA commentator indicated that despite the change in language, '[i]t was intended that a judge disqualify himself if he had made up his mind on the merits before he heard the case.' Senate Hearing, supra note 2, at 93 (Professor Thode).

FN52. See infra notes 12-18 and accompanying text for a discussion of the judicial gloss on disqualification for bias or prejudice.

FN53. 28 U.S.C. § 455(a) (1982).

FN54. See Redish & Marshall, supra note 1, at 472-75 (analysis and critique of balancing test applied to procedural due process rights).

FN55. See Bloom, Judicial Bias and Financial Interest as Grounds for Disqualification of Federal Judges, 35 CASE W. RES. L. REV. 662, 664-65 (1985) (excessive disqualification would damage efficient administration of justice).

FN56. See In re Cement Antitrust Litig., 688 F.2d 1297, 1313 (9th Cir.) (judge disqualified in complex class action suit because his wife had minimal stock holdings in plaintiff companies), aff'd mem. sub nom., Arizona v. United States Dist. Ct., 459 U.S. 1191 (1982). This case has attracted critical comment as an example of the high burden imposed by the expansive definition of financial interest in § 455(b)(4) and the impossibility of waiver under § 455(e) for § 455(b) cases. See Bloom, supra note 55, at 702-05 (disqualification for de minimis financial interest without possibility of waiver disrupts litigation and wastes judicial resources); Note, Bias and Interest: Should They Lead to Dissimilar Results in Judicial Qualification Practice?, 27 ARIZ. L. REV. 171, 189-92 (1985) (per se disqualification for minimal financial interests harmful to public perception of judiciary).

FN57. Statements from both the Senate and the House of Representatives suggested that Congress found that the large numbers of federal judges permitted liberal standards for disqualification and sharp restrictions on waiver of disqualification. Senate Hearing, supra note 2, at 74; House Report, supra note 4, at 6357. See supra note 30 and accompanying text for a discussion of congressional elimination of the duty to sit.

FN58. Concern for judge-shopping is evident in the House Report which stated: 'Nothing in this proposed legislation should be read to warrant the transformation of a litigant's fear that a judge may decide a question against him into a 'reasonable fear' that the judge will not be impartial. Litigants ought not have to face a judge where there is a reasonable question of impartiality, but they are not entitled to judges of their own choice.' House Report, supra note 4, at 6355. See also In re International Business Machs. Corp., 618 F.2d 923, 929 (2d Cir. 1980) (adverse ruling cannot disqualify judge).

FN59. See supra notes 109-94 and accompanying text for a discussion of the judicial development of substantive grounds for disqualification under § 455(a).

FN60. See Note, Disqualification of Judges and Justices in the Federal Courts, 86 HARV. L. REV. 736, 746-47 (1973) (concern for appearances necessary because judicial authority rests ultimately on public acceptance of judicial decisionmaking).

FN61. See Hall v. Small Business Admin., 695 F.2d 175, 178-79 (5th Cir. 1983) (to satisfy appearance of impartiality test of § 455(a), disqualification must be based on reasonable conclusion from objectively ascertainable facts, not on subjective assessment of judge's state of mind).

FN62. The language of 28 U.S.C. § 455 (1982), which gives judges the responsibility to disqualify themselves in several specified circumstances, provides for disqualification where no one but the judge knows the reason. Disqualification of this sort is generally not documented by written opinion. An instance of this use of § 455 may be seen in United States v. Merkt, 794 F.2d 950, 960 (5th Cir. 1986) (judge's unexplained voluntary recusal in prior case involving defendant is not sufficient grounds for disqualification in subsequent case involving defendant), cert. denied,

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107 S. Ct. 1603 (1987).

FN63. See supra notes 21-22 and accompanying text for a discussion of waiver requirements in § 455(e), prohibiting waiver where disqualification is based on § 455(b).

FN64. 28 U.S.C. §§ 144, 455(b)(1) (1982). See supra note 12 for the text of § 455(b)(1); see supra note 35 for the text of § 144.

FN65. 28 U.S.C. § 144.

FN66. Id. § 455(b)(1) (emphasis added).

FN67. For the standard applied to § 144, see Chitimacha Tribe v. Harry L. Laws Co., 690 F.2d 1157, 1165 (5th Cir. 1982) (§ 144 affidavit sufficient if it alleges facts which, if true, would convince reasonable person that bias exists), cert. denied, 464 U.S. 814 (1983); see also United States v. Balistrieri, 779 F.2d 1191, 1199 (7th Cir. 1985), cert. denied, 106 S. Ct. 3284 (1986); United States v. Thompson, 483 F.2d 527, 528 (3d Cir. 1973).

Courts tend to treat § 455 as a unit when setting forth the standard, rather than treating § 455(b)(1) separately from § 455(a). See Story, 716 F.2d at 1091 (reasonable person standard applied to § 455 as a whole); Chitimacha, 690 F.2d at 1167 (charges of partiality based on §§ 455(a) and (b) resolved by application of reasonable person standard).

FN68. See Chitimacha, 690 F.2d at 1165 (§ 144 affidavit must convince a reasonable person); Balistrieri, 779 F.2d at 1202 (requirement that facts convince a reasonable person of bias applied to both § 455(b)(1) and § 144).

FN69. Courts generally apply a three-part test for legal sufficiency, requiring that the facts set forth in the affidavit (1) be material and stated with particularity (2) be such that, if true, they would convince a reasonable person that bias exists; and (3) show personal rather than judicial bias. United States v. Merkt, 794 F.2d 950, 960 n.9 (5th Cir. 1986), cert. denied, 107 S. Ct. 1603 (1987); see also Phillips v. Joint Legislative Comm'n., 637 F.2d 1014, 1019 (5th Cir. 1981), cert. denied, 456 U.S. 960 (1982); Thompson, 483 F.2d at 528.

FN70. Thompson, 483 F.2d at 528 (emphasis added); accord Balistrieri, 779 F.2d at 1199; United States v. Serrano, 607 F.2d 1145, 1150 (5th Cir. 1979), cert. denied, 446 U.S. 910 (1980). The standard has become more rigorous over they years. In Berger v. United States, the Supreme Court demanded only that the affidavit 'give fair support to the charge of a bent of mind that may prevent or impede impartiality of judgment.' 255 U.S. at 33-34.

FN71. See infra note 83 and accompanying text for discussion of the § 455(a) standard.

FN72. Berger, 255 U.S. at 36.

FN73. Balistrieri, 779 F.2d at 1199 (judge must assume facts are true, even if judge knows them to be false); Mims v. Shapp, 541 F.2d 415, 417 (3d Cir. 1976) (judge must accept truth of allegations and good faith of pleader even if judge has knowledge to the contrary).

FN74. See, e.g., In re Yagman, 796 F.2d 1165, 1181-82 (9th Cir. 1986) (§ 455 treated as unit in setting forth reasonable doubt standard for disqualification); United States v. Story, 716 F.2d 1088, 1091 (6th Cir. 1983) (single reasonable doubt standard established for § 455).

Focus on § 455 is not surprising. Judges can save face by disqualifying themselves under § 455(a), on grounds that a reasonable person could question their impartiality, rather than admitting they are actually biased by disqualifying themselves under § 455(b)(1). See Balistrieri, 779 F.2d at 1203 (judges may be especially reluctant to recuse themselves when doing so requires admission that actual bias or prejudice has been proved). Likewise, it is logical for one to surmise that courts of appeals support that focus, because they may then avoid directly impugning the

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integrity of district court judges by using § 455(a) instead of § 455(b)(1).

FN75. See, e.g., United States v. Sibla, 624 F.2d 864, 867 (9th Cir. 1980) (§ 455(b)(1) simply provides specific example of situation in which a judge's 'impartiality might reasonably be questioned' pursuant to § 455(a)); United States v. Conforte, 624 F.2d 869, 881 (9th Cir.) (same test for subsections (a) and (b) which disqualifies on a reasonable person standard for either the appearance or the fact of bias) cert. denied, 449 U.S. 1012 (1980).

Bloom, supra note 55, at 675, suggests that the Ninth Circuit Court of Appeals applies the bias in fact requirement of § 455(b)(1) to both § 455(a) and § 455(b)(1). But the court made clear in Conforte that both sections would be a evaluated under the standard requiring disqualification for the appearance of bias set forth in § 455(a). 624 F.2d at 881.

The Fifth Circuit Court of Appeals, soon after § 455 was revised, issued an ambiguous holding that could be interpreted as imposing a bias in fact requirement on both § 455(a) and § 455(b)(1). Parrish v. Board of Comm'rs, 524 F.2d 98, 103-04 (5th Cir. 1975) (en banc), cert. denied, 425 U.S. 944 (1976). See Comment, Disqualification of Federal Judges for Bias or Prejudice, 46 U. CHI. L. REV. 236, 248 n.66 (1978) (Parrish holding ambiguous but compatible with appearance of bias rule). But cf. Bloom, supra note 55, at 675 (Parrish and subsequent cases require bias in fact). More recent Fifth Circuit decisions clearly apply the § 455(a) requirements to both § 455(a) and § 455(b)(1). See United States v. Merkt, 794 F.2d 950, 960 n.8 (5th Cir. 1986) (test of whether reasonable person would 'harbor doubts' applied to both sections), cert. denied, 107 S. Ct. 1603 (1987).

FN76. 779 F.2d 1191 (7th Cir. 1985), cert. denied, 106 S. Ct. 1490 (1986).

FN77. Id. at 1202. The Balistrieri court apparently based its holding on a literal reading of the statute. The court stated that actual bias was required after simply reciting the statutory language and offered no other support for this position. Id.

FN78. Id. at 1202. The court reasoned that '[t]he disqualification of a judge for actual bias or prejudice is a serious matter, and it should be required only when the bias or prejudice is proved by compelling evidence.' Id. The court found no actual bias on the part of the judge who had previously worked as a prosecutor and allegedly targeted the defendant as the head of an organized crime family. Id. at 1196-97.

FN79. See supra note 12 for the text of § 455(a).

FN80. Hall v. Small Business Admin., 695 F.2d 175, 178-79 (5th Cir. 1983) (test under § 455(a) is appearance of partiality, not actual prejudice); see also Balistrieri, 779 F.2d at 1204; United States v. Nobel, 696 F.2d 231, 235-36 (3d Cir. 1982), cert. denied, 462 U.S. 1118 (1983).

FN81. 28 U.S.C. § 455(a).

FN82. Senate Hearing, supra note 2, at 2, 74 (Senator Burdick); House Report, supra note 4, at 6354. See Roberts v. Bailar, 625 F.2d 125, 129 (6th Cir. 1980) (disqualification required even where question is close).

FN83. See, e.g., United States v. Nobel, 696 F.2d at 235-36 (3d Cir. 1982) (§ 455(a) disqualifies on appearance of bias standard), cert. denied, 462 U.S. 1118 (1983); Chitimacha Tribe v. Harry L. Laws Co., 690 F.2d 1157, 1165 (5th Cir. 1982) (standard is whether reasonable person would harbor doubts about judge's impartiality; appearance of impartiality is required), cert. denied, 464 U.S. 814 (1983).

FN84. See Idaho v. Freeman, 507 F. Supp. 706, 723-725 (D. Idaho 1981) (Fifth and Ninth Circuits interpret § 455(a) as requiring bias in fact) (citing United States v. Olander, 584 F.2d 876, 882 (9th Cir. 1978) (§ 455(a) should be interpreted as setting up same test for disqualification as § 455(b)(1) and § 144) and Parrish v. Board of Comm'rs, 524 F.2d 98, 101-02 (5th Cir. 1975) (en banc) (gloss on § 144 applies fully to § 455), cert. denied, 425 U.S. 944 (1976));

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see also Bloom, supra note 55, at 675 (Fifth Circuit and Ninth Circuit cases require bias in fact).

FN85. The Fifth Circuit, which may have required bias in fact at one time, has more recently stated clearly that the standard under § 455(a) is the appearance of bias. Hall v. Small Business Admin., 695 F.2d 175, 178-79 (5th Cir. 1983) (test under § 455(a) is appearance of partiality rather than actual bias). See also Comment, supra note 74, at 248 n.66 (majority opinion in Parrish ambiguous; can be read as acknowledging appearance of bias standard for § 455(a)).

The Ninth Circuit backed away from the bias in fact requirement in United States v. Conforte, 624 F.2d 869 (9th Cir. 1980). The Conforte court interpreted its Olander holding to mean that the same substantive rules regarding bias or prejudice would apply whether the court was determining the appearance or the fact of bias. Conforte, 624 F.2d at 880 (citing Olander, 584 F.2d at 882).

FN86. United States v. Balistrieri, 779 F.2d 1191, 1204 (7th Cir. 1985), cert. denied, 106 S. Ct. 1490 (1986). Accord New York City Hous. Dev. Corp. v. Hart, 796 F.2d 976, 979 (7th Cir. 1986); Union Carbide Corp. v. U.S. Cutting Serv., Inc., 782 F.2d 710, 713 (7th Cir. 1986).

FN87. See supra notes 76-78 and accompanying text for a discussion of the Balistrieri court's analysis of § 455(b)(1).

FN88. 779 F.2d at 1204.

FN89. Id.

FN90. Id. at 1204-05.

FN91. See supra notes 73-74 and accompanying text for a discussion of the courts' tendency to focus on § 455(a).

FN92. See, e.g., Southern Pacific Communications Co. v. American Tel. & Tel. Co., 740 F.2d 980, 983 (D.C. Cir. 1984) (disqualification issue arose as a result of opinions expressed in judge's memorandum opinion), cert. denied, 470 U.S. 1005 (1985).

FN93. House Report, supra note 4, at 6355.

FN94. Id.

FN95. Senate Hearing, supra note 2, at 112 (statements of Prof. Thode and Mr. Westphal).

FN96. Id. at 87-88. Judge Traynor, chairman of the ABA Special Committee of Standards of Judicial Conduct, objected to what is now § 455(b)(3), and argued that the last part of that provisions, not found in the ABA Code, was unnecessary. Id.

FN97. See supra note 12 for text of §§ 455(b)(4) and 455(d)(4). But see Note, supra note 56, at 189-92 (per se disqualification for minimal financial interests harmful to public perception of judiciary).

FN98. See infra notes 99-107 and accompanying text for a discussion of Supreme Court cases setting forth the due process standards.

FN99. See, e.g., Ward v. Village of Monroeville, 409 U.S. 57, 60-61 (1972) (due process right violated where judge is mayor of town receiving benefit of fines); In re Murchison, 349 U.S. 133, 136-37 (1955) (due process right violated where trial judge also acted as prosecuting judge); Tumey v. Ohio, 273 U.S. 510, 523 (1927) (due process right violated where judge's salary paid in part by fines judge imposed).

FN100. See, e.g., Aetna Life Ins. Co. v. Lavoie, 106 S. Ct. 1580, 1585 (1986) (only in extreme cases would

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 322

disqualification on basis of personal bias or prejudice be constitutionally required); Tumey, 273 U.S. at 523 (not all questions of judicial disqualification are constitutional questions). These cases involved disqualification of state court judges.

Other due process decisions dealing with adjudicative impartiality have involved administrative decisionmakers. See Marshall v. Jerrico, Inc., 446 U.S. 238, 242-43 (1980) (decision by regional administrator in Department of Labor not required to meet impartiality standards applied to judges); FTC v. Cement Inst., 333 U.S. 683, 701-02 (1948) (FTC's expressed opinions on points of law neither evidence of bias nor violative of due process).

In the few federal judicial disqualification cases heard by the Supreme Court, the Court has not reached the question of due process but rather has confined itself to interpreting the federal statute at issue. See United States v. Grinnell Corp., 384 U.S. 563, 580-83 (1966) (applying § 144 where judge's personal bias alleged); Berger v. United States, 255 U.S. 22, 34-35, (1921) (applying Act of March 3, 1911, ch. 231, § 21, 36 Stat. 1090, precusor to § 144). The Court's focus on statutory interpretation is consistent with its practice of resolving cases on statutory grounds if possible before reaching constitutional questions. See Wood v. Strickland, 420 U.S. 308, 314 (1975) (Court practice is to deal with dispositive statutory issue before considering constitutional construction issues).

FN101. 106 S. Ct. 1580 (1986).

FN102. Id. at 1582-83.

FN103. Id. at 1586-87.

FN104. Id. at 1585, 1588.

FN105. Id. at 1585. The Court determined that the appellant's allegation of bias based on the chief judge's expressions of general frustration with insurance companies did not rise to the level of a constitutional question. Id. The Court did not, however, indicate what circumstances or what evidence of bias would rise to the level of a due process violation.

For a critique of the judicial reluctance to find violations of due process where bias or prejudice is alleged, see Redish & Marshall, supra note 1, at 500-02 (distinction in constitutional treatment between personal bias and interest unjustified).

FN106. Lavoie, 106 S. Ct. at 1587-88. The Court ruled that the alleged interest of the other judges on the panel, who were members of the plaintiff class in a suit against another insurance company, was 'highly speculative and contingent,' and thus did not meet the due process test that an interest be direct, personal, substantial, and pecuniary. Id. at 1588.

FN107. Id. at 1587 (quoting Ward v. Village of Monroeville, 409 U.S. 57, 60-61 (1972) and In re Murchison, 349 U.S. 133, 136 (1955) respectively).

FN108. See supra notes 86-90 and accompanying text for a discussion of the Seventh Circuit position concerning appellate review of disqualification decisions.

FN109. See infra notes 124-50 and accompanying text for a discussion of the extrajudicial source requirement. See supra notes 51-83 and accompanying text for discussion of disqualification for opinions on the law.

FN110. See infra notes 184-88 and accompanying text for a discussion of disqualification for bias toward an attorney.

FN111. See supra notes 89-94 and accompanying text for discussion of courts' refusal to disqualify on the basis of general background and experience.

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FN112. 28 U.S.C. § 144 (1982).

FN113. Id. § 455 (1982).

FN114. 517 F.2d 1044 (5th Cir. 1975), cert. denied, 425 U.S. 944 (1976).

FN115. Id. at 1052.

FN116. Id.

FN117. See, e.g., United States v. Story, 716 F.2d 1088, 1091 (6th Cir. 1983) (well settled that §§ 144 and 455 'must be construed in pari materia') (quoting City of Cleveland v. Kruppansky, 619 F.2d 576, 578 (6th Cir.), cert. denied 449 U.S. 834 (1980)); United States v. Sibla, 624 F.2d 864, 869 (9th Cir. 1980) (§§ 455(a) & (b)(1), like § 144, require recusal only if bias or prejudice is directed against party and stems from extrajudicial source); In re International Business Machs. Corp., 618 F.2d 923, 928-29 (2d Cir. 1980) (§§ 455(a) and 455(b)(1) require that bias be personal and from extrajudicial source).

FN118. See United States v. Haldeman, 559 F.2d 31, 132 n.297 (D.C. Cir. 1976) (judicial understanding of § 144 applies to revised § 455, which requires disqualification when impartiality may reasonably be questioned), cert. denied, 431 U.S. 933 (1977).

A few courts have disagreed, stating that the judicial interpretation of § 144 does not carry over to § 455(a). United States v. Coven, 662 F.2d 162, 168 (2d Cir. 1981), cert. denied, 456 U.S. 916 (1982). See also United States v. Cepeda Penes, 577 F.2d 754, 758 (1st Cir. 1978) (§ 455(a) permits disqualification on evidence from judicial source). The minority view does not, however, produce results significantly different from the results reached by courts which apply the § 144 judicial gloss to § 455(a). The courts that limit the applicability of the § 144 judicially-created rules take them as being without exception or nuance. In contrast, courts that apply the §§ 144 requirements to § 455(a) include exceptions within the standards they apply to each of the sections. Compare Coven, 662 F.2d at 168-69 (information from a judicial source relevant but not sufficiently prejudicial to disqualify without any other basis in record for questioning judge's impartiality) with Nicodemus v. Chrysler Corp., 596 F.2d 152, 156-57 (6th Cir. 1979) (emotional response by judge within judicial context sufficiently prejudicial to warrant disqualification).

FN119. See infra notes 127-34 and accompanying text for a discussion of the advantages of the extrajudicial source requirement.

FN120. See, e.g., United States v. Lee, 648 F.2d 667, 669 (9th Cir. 1981) (nature of judicial system is such that judges must rise above impermissible influences); United States v. Sinclair, 424 F. Supp. 715, 718 (D. Del. 1976) (affidavit must be strictly construed because judge presumed impartial), aff'd, 566 F.2d 1171 (3d Cir. 1977); see also infra notes 169-71 and accompanying text for a discussion of the presumption of impartiality in the context of disqualification for judges' opinions on the law.

FN121. See infra notes 135-40 and accompanying text for a discussion of the requirement for clear evidence of personal prejudice.

FN122. See infra notes 178-83 for a discussion of a proposal to permit disqualification based on strongly-felt disagreement with the law.

FN123. See infra notes 141-44 and accompanying text for a discussion of the pervasive prejudice exception to the extrajudicial source requirement.

FN124. See, e.g., United States v. Haldeman, 559 F.2d 31, 133 (D.C. Cir. 1976) (§ 144 does not disqualify judges on basis of prior judicial rulings or in-court comments prompted by legal proceedings), cert. denied, 431 U.S. 933

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(1977).

FN125. 384 U.S. 563 (1966).

FN126. Id. at 583.

FN127. Id. at 580-83 (judge's comments critical of attorney's handling of case are not grounds for disqualification). See also Johnson v. Trueblood, 629 F.2d 287, 291 (3d Cir. 1980) ('intemperate' statements in settlement conference based on perception of case are not grounds for disqualification), cert. denied, 450 U.S. 999 (1981).

FN128. See Ex parte American Steel Barrel Co., 230 U.S. 35, 44 (1913) (adverse rulings not grounds for disqualification).

FN129. In re International Business Machs. Corp., 618 F.2d 923, 927-30 (2d Cir. 1980) (statistical evidence of pattern of adverse ruling not grounds for disqualification under §§ 144 or 455).

FN130. See Phillips v. Joint Legislative Comm., 637 F.2d 1014, 1020 (5th Cir. 1981) (outmoded and improper racial remarks incorporated in prior rulings do not disqualify judge in subsequent civil rights case), cert. denied, 456 U.S. 960 (1982); United States v. Jackson, 627 F.2d 1198, 1207 n.20 (D.C. Cir. 1980) (prior judicial exposure to same type of case inadequate basis for showing personal bias).

FN131. For application of the extrajudicial source requirement to bail hearings, see, e.g., United States v. Archbold-Newball, 554 F.2d 665, 681-82 (5th Cir.) (judge's bail denial based on stated belief of police testimony that defendants were in conspiracy not grounds for recusal), cert. denied, 434 U.S. 1000 (1977).

For application of the extrajudicial source requirement to other pretrial proceedings, see, e.g., United States v. Porter, 701 F.2d 1158, 1166 (6th Cir.) (judge's comment during preliminary hearing that defendants were 'apparently caught red-handed' not grounds for disqualification absent pervasive bias), cert. denied, 464 U.S. 1007 (1983); United States v. Cepeda Penes, 577 F.2d 754, 756-58 (1st Cir. 1978) (judge who heard aborted attempt to plead nolo contendere not disqualified from presiding over trial).

For application of the extrajudicial source requirement to trials, see, e.g., Demjanjuk v. Petrovsky, 776 F.2d 571, 577 (6th Cir. 1985) (judge who presided over denaturalization hearing need not disqualify himself from extradition hearing or from considering habeas corpus relief), cert. denied, 106 S. Ct. 1198 (1986); In re Corrugated Container Antitrust Litig., 614 F.2d 958, 963-66 (5th Cir.) (judge who presided over criminal trial not disqualified from hearing subsequent civil trial), cert. denied, 449 U.S. 888 (1980); United States v. Partin, 552 F.2d 621, 637 n.20 (5th Cir.) (judge not disqualified from presiding over retrial), cert. denied, 434 U.S. 903 (1977).

FN132. See, e.g., United States v. Studley, 783 F.2d 934, 939-40 (9th Cir. 1986) (fact that defendant publically denounced and filed lawsuit against judge not grounds for disqualification); United States v. Phillips, 664 F.2d 971, 1000-04 (5th Cir. 1981) (no extrajudicial source of bias to disqualify judge who learned of and discussed defendant's plans to disrupt trial and his threats against judge's life), cert. denied, 457 U.S. 1136 (1982).

FN133. See In re International Business Machs. Corp., 618 F.2d 923 (2d Cir. 1980), in which the court stated: 'A trial judge must be free to make rulings on the merits without the apprehension that if he makes a disproportionate number in favor of one litigant, he may have created the impression of bias.' Id. at 929. See also Johnson v. Trueblood, 629 F.2d 287, 291 (3d Cir. 1980) (extrajudicial source rule extended to statements in settlement conference to avoid unduly hampering judge's ability to effectuate settlement), cert. denied, 450 U.S. 999 (1981).

The use of this rationale in Phillips v. Joint Legislative Comm., 637 F.2d 1014 (5th Cir. 1981), cert. denied, 456 U.S. 960 (1982), in response to allegations of racism, raises the question whether the protection afforded by the extrajudicial source requirement extends too far. The court stated:

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 325

> We would be reluctant, in any but an extreme case, to base a disqualification order on . . . allegations [of a pattern of racism in prior opinions]. It is a district judge's duty to conduct trials, weigh evidence, consider the law, exercise his discretion, and reach decisions in the cases on which he sits. If he understands that a seemingly harsh comment toward a party or an attorney, or a perceived tendency to give severe sentences to some class of offenders, or an aggregate imbalance in victories for plaintiffs or defendants in a particular class of cases may subject him to a train of successful recusal motions in future cases, he may consciously or subconsciously shape his judicial actions in ways urelated to the merits of the cases before him.
>
> Id. at 1020.

FN134. See, e.g., Wilks v. Israel, 627 F.2d 32, 37 (7th Cir. 1980) (allowing defendant's assault of judge to support disqualification would encourage unruly courtroom behavior and result in disruption of judicial administration), cert. denied, 449 U.S. 1086 (1981).

FN135. 255 U.S. 22 (1921).

FN136. Id. at 28-29. See also Connelly v. United States Dist. Ct., 191 F.2d 692, 694-95 (9th Cir. 1951) (judge disqualified who publicly stated that Communists hid behind Bill of Rights and who said to counsel, 'I'm sorry to see you get mixed up with these Commies.').

FN137. 625 F.2d 125 (6th Cir. 1980).

FN138. The party was the local postmaster for whom the Postmaster General was substituted. Id. at 127.

FN139. Id. at 127.

FN140. Id. at 129.

FN141. 517 F.2d 1044, 1051 (5th Cir. 1975), cert. denied, 425 U.S. 944 (1976).

FN142. 655 F.2d 44 (5th Cir. 1981).

FN143. Id. at 45 & n.2.

FN144. Id. at 47.

FN145. 596 F.2d 152 (6th Cir. 1979).

FN146. Id. at 157. The district judge stated:

> This thing is the most transparent and the most blatant attempt to intimidate witnesses and parties that I have seen in a long time. I don't believe anything that anybody from Chrysler tells me because there is nothing in the record that is before me and in my experience in dealing with this case that gives me reason to believe that they are worthy of credence by anybody. They are a bunch of villains and they are interested only in feathering their own nests at the expense of everybody they can, including their own employees, and I don't intend to put up with it.
>
> Id. At a later point in the trial, the judge indicated that the award he granted was shaped by his negative assessment of the defendant. Id. at 156-57.

In Shank v. American Motors Corp., 575 F. Supp. 125 (E.D. Pa. 1983), a district court judge reacted in similar fashion to the defendant automobile manufacturers. The judge refused to disqualify himself, alleging that his statement arose out of judicial experience and did not indicate extrajudicial bias. Id. at 129. He said, 'Automobile manufacturers

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FOIA # 57720 (URTS 16326) DocId: 70105318 Page 326

are among the most devious groups of defendants that I have seen in twenty-one years on the Bench.' Id. The defendants did not appeal this denial of disqualification.

FN147. Id. at 156. The court stated: "Often some degree of bias develops inevitably during a trial. Judges cannot be forbidden to feel sympathy or aversion for one party or the other. Mild expressions of feeling are as hard to avoid as the feeling itself." Nicodemus, 596 F.2d at 156 (quoting Whitaker v. McLean, 118 F.2d 596, 596 (D.C. Cir. 1941)).

FN148. Nicodemus, 596 F.2d at 156 (quoting Whitaker v. McLean, 118 F.2d at 596).

FN149. See, e.g., Mayberry v. Pennsylvania, 400 U.S. 455, 463 (1971) ('A judge cannot be driven out of a case'); Wilks v. Israel, 627 F.2d 32, 37 (7th Cir. 1980) (judge not disqualified for response toward defendant who had assaulted him), cert. denied, 449 U.S. 1086 (1981).

FN150. See Mayberry, 400 U.S. at 465-66 (judge became 'personally embroiled' with defendant, and therefore defendant given public trial before another judge). Compare In re Jafree, 741 F.2d 133, 136-37 (7th Cir. 1984) (in non-summary contempt proceeding for defamatory actions toward district court judges in which court did not follow proper procedure, judges disqualified for being personally embroiled in the controversy) with United States v. Greer, 714 F.2d 358, 360 (4th Cir. 1983) (judge who objected to attorney's accusation that he sentenced on racial basis and then called a recess, permitting time for emotions to cool, not disqualified for bias) and Wilks, 627 F.2d at 36-37 (although judge responded to assault, reaction did not disqualify him because he claimed down and conducted fair trial).

FN151. This rule is mitigated somewhat by 28 U.S.C. § 455(b)(3), which provides that judges who had been government employees are disqualified from a case if they previously served as counsel, adviser, or material witness concerning the proceedings, or if they expressed an opinion on the merits of the case. Id.

FN152. Cipollone v. Liggett Group, Inc., 802 F.2d 658, 659-60 (3d Cir. 1986) (judge's prior knowledge of issues in products liability suit against tobacco companies not grounds for disqualification), cert. denied, 107 S. Ct. 907 (1987).

FN153. 408 U.S. 1 (1972) (suit against army surveillance dismissed); 409 U.S. 824 (1972) (memorandum of Rehnquist, J., rejecting motion for disqualification).

FN154. 408 U.S. at 2.

FN155. 409 U.S. at 824-25.

FN156. Id.

FN157. Id. at 829. The revised version of § 455 has not yet been enacted. For the text of the disqualification statute in effect at the time, see supra note 28.

During the hearing process prior to Justice Rehnquist's confirmation as Chief Justice, information regarding his role in formulating the surveillance program became public and prompted criticism of his failure to disqualify himself in Tatum. Members of Congress and the legal community maintained that his involvement in policy-making required disqualifications. See Rehnquist's Critics Press Charges That He Was Unethical on Court, N.Y. Times, Sept. 11, 1986, p. B12, col. 1 (statements of Hazard, an expert on judicial ethics and a Republican, to the effect that Rehnquist should have disqualified himself in Tatum); Rehnquist Acted Improperly by Ruling On Surveillance Case, Ethics Expert Says, Wall St. J., Sept. 11, 1986, at 64, col. 1 (Yale Law School Professor Geoffrey Hazard statements that Rehnquist should not have participated in Tatum because of direct involvement in events that culminated in suit); New Questions Raised About Rehnquist's Role in Army Surveillance of Protestors, Wall St. J., Sept. 10, 1986, at 64, col. 1 (Senate Democrats state that information regarding Rehnquist's involvement in formulating surveillance policy

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raises questions regarding his ethical judgment and sensitivity to the appearance of impropriety).

FN158. 409 U.S. at 835.

FN159. Id. at 836. Justice Rehnquist also argued that federal judges have a 'duty to sit' if not disqualified. Id. at 837. Congress specifically rejected this rule when it passed the revised disqualification statute later that same year. See supra note 30 and accompanying text for a discussion of the duty to sit.

FN160. See supra note 12 for text of § 455(b)(3).

FN161. See Senate Hearings, supra note 2, at 88-89 (need for § 455(b)(3) explained by reference to Laird v. Tatum).

FN162. See, e.g., Shaw v. Martin, 733 F.2d 304, 315-16 (4th Cir.) (vote for death penalty no more significant than oath binding judges to apply laws of legislature; it is not grounds for disqualification), cert. denied, 469 U.S. 873 (1984); United States v. Allen, 675 F.2d 1373, 1385 (9th Cir. 1980) (statement that marijuana importation is a serious crime with cancer-like effect on society is restatement of congressional purpose and cannot be grounds for disqualification), cert. denied, 454 U.S. 833 (1981); Smith v. Danyo, 585 F.2d 83, 87 (3d Cir. 1978) (statement that diversity cases do not belong in federal court is statement of legal principle and does not disqualify judge); see also Lawton v. Tarr, 327 F. Supp. 670, 671-72 (E.D.N.C. 1971) (judge who had publicly expressed his strong objection to Vietnam war refused to disqualify himself from Selective Service case).

FN163. 740 F.2d 980 (D.C. Cir. 1984), cert. denied, 470 U.S. 1005 (1985).

FN164. Southern Pacific Communications Co. v. American Tel. & Tel. Co., 556 F. Supp. 825 (D.D.C. 1982), aff'd, 740 F.2d 980 (D.C. Cir. 1984), cert. denied, 470 U.S. 1005 (1985).

FN165. 740 F.2d at 983, 988 n.7.

FN166. Id. at 990.

FN167. Id. at 991.

FN168. Id. The court suggested that judges should not be disqualified if they are 'capable of refining' their views in the process of the case, but they should be disqualified if their minds are 'irrevocably closed.' Id. Applying this test to the district court judge's handling of the AT&T case, the court found that the judge did not hold a fixed opinion at the outset of the case, as evidenced by his denial of a motion to dismiss the case on the basis of antitrust immunity, and that his evenhanded administration of the case provided no evidence of a 'closed mind' during trial. Id. at 991-92.

FN169. See id. at 993 (evidence must be weighed against strong presumption that judges do not substitute their personal views for controlling law).

FN170. Cf. Bloom, supra note 55, at 689 (previously stated opinion on important issue in case could lead reasonable person to question judge's impartiality).

Bloom addressed this issue prior to the circuit court decision in Southern Pacific Communications. He perceived the policy against disqualifying judges for opinions on the law as a blanket prohibition, rather than as a policy giving rise to a strong presumption of impartiality. Id. at 688. Bloom advocated replacing the blanket prohibition with a case-by-case analysis that would disqualify judges for the appearance of bias, and that would take into account 'whether and how widely the judge's views are publicly known, how strongly the views are held, whether the proper resolution of the legal issue is unsettled, and whether his views relate to the legal issue as applied in the specific factual context of the case . . ..' Id. at 697.

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FN171. See Southern Pacific Communications, 740 F.2d at 991 (each new case confronts judge with new factual context, new evidence, and new efforts at persuasion; test is whether judge's mind is irrevocably closed with respect to issues as they arise in context of specific case).

FN172. See United States v. Clements, 634 F.2d 183, 187 (5th Cir. 1981) (fixed sentencing policy, established through judge's statement or prior record in similar cases, may disqualify); United States v. Thompson, 483 F.2d 527, 528-29 (3d Cir. 1973) (judge's statement showing policy of imposing stiff sentences for Selective Service violations grounds for disqualification).

FN173. 483 F.2d 527 (3d Cir. 1973). Although the Thompson court held that a litigant can disqualify a judge through a pretrial § 144 affidavit alleging a fixed sentencing policy, the court was evaluating a case in which the judge had declined to disqualify himself, id. at 528, and had actually imposed the thirty-month sentence he had indicated was his minimum. Id. The court, however, focused on the allegations in the affidavit, rather than the judge's conduct in the case. Id. at 528-29.

FN174. Id. at 528.

FN175. Id. See United States v. Townsend, 478 F.2d 1072, 1074 (3d Cir. 1973) (judge disqualified for statement showing fixed opinion on sentencing).

FN176. 483 F.2d at 529. One member of the circuit court panel filed a dissent in which he argued that the class was a judicial one, defined merely by their violation of the Selective Service Act, and not by a 'trait extraneous to the judicial process.' Id. at 530 (Adams, J., dissenting).

FN177. Id. at 529.

FN178. See Reserve Mining Co. v. Lord, 529 F.2d 181, 188-89 (8th Cir. 1976) (judge disqualified for disregarding appeals court mandate regarding district court jurisdiction).

FN179. See United States v. Allen, 675 F.2d 1373, 1385 (9th Cir. 1980) (anti-drug statement not grounds for disqualification in drug smuggling trial), cert. denied, 454 U.S. 833 (1981).

FN180. See Shaw v. Martin, 733 F.2d 304, 316 (4th Cir.) (judge who as legislator had voted for death penalty not disqualified), cert. denied, 105 S. Ct. 230 (1984).

FN181. Courts have shown an appropriate reluctance to disqualify on the basis of disagreement with applicable law. The Southern Pacific Communications court articulated the reason for this reluctance when it stated:

> It is well established . . . that a judge is not disqualified merely because he personally disagrees with the policy underlying a law that he is bound to apply in a case [since] . . . '[i]n fulfilling the functions of applying or considering the validity of a statute, or a government program, the judge endeavors to put aside personal views as to the desirability of the law or program . . ..'
>
> 740 F.2d at 993 (quoting Association of Nat'l Advertisers, Inc. v. FTC, 627 F.2d 1151, 1175 (D.C. Cir. 1979) (Leventhal, J., concurring), cert. denied, 447 U.S. 921 (1980)).

FN182. For example, a judge who had previously campaigned for political office on an anti-abortion platform could be disqualified from abortion cases.

FN183. See Southern Pacific Communications, 740 F.2d at 993 (allegation that judge allowed feelings to dominate considered but rejected on basis of record).

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FN184. See Davis v. Board of School Comm'rs, 517 F.2d 1044, 1052 (5th Cir. 1975) (disqualification should be based on judicial bias toward a party rather than counsel), cert. denied, 425 U.S. 944 (1976); cf. Gilbert v. City of Little Rock, 722 F.2d 1390, 1298-99 (8th Cir. 1983) (judge who voluntarily disqualified herself from cases involving certain attorney not required to disqualify herself from case in which that attorney had previously represented party because antipathy to attorney insufficient grounds for disqualification on personal prejudice), cert. denied, 466 U.S. 972 (1984).

FN185. See, e.g., In re International Business Machs. Corp., 618 F.2d 923, 932 (2d Cir. 1980) (court considered incidents of intemperate behavior toward attorneys and concluded they did not show bias toward party).

FN186. 540 F.2d 459 (10th Cir. 1976), cert. denied, 429 U.S. 951 (1976).

FN187. Id. at 462.

FN188. In re Yagaman, 796 F.2d 1165, 1178 (9th Cir. 1986) (tension between court and attorney did not create bias toward party). The court described this tension as a normal component of the judicial process, stating that '[b]ecause the nature of our system is adversarial, parties will occasionally be uncooperative, both with each other and with the court, and courts will sometimes be exacting.' Id. See also In re International Business Machs. Corp., 618 F.2d at 932 (incidents of intemperate behavior 'endemic to a trial of this dimension').

FN189. See Paschall v. Mayone, 454 F. Supp. 1289, 1300-01 (S.D.N.Y. 1978) (judge not disqualified for experience as an NAACP attorney).

FN190. 418 F. Supp. 1 (S.D.N.Y. 1975).

FN191. Id. at 4.

FN192. Id. Disqualification sought on the basis of a judge's background and experience was also rejected in Pennsylvania v. Local 542, Int'l Union of Operating Eng'rs, 388 F. Supp. 155, 182 (E.D. Pa. 1974), aff'd, 552 F.2d 498 (3d Cir. 1977). The defendants, who were charged with discriminating against a class of black plaintiffs on the basis of race, sought to disqualify Judge Higginbotham by means of a § 144 affidavit alleging that he was black and had identified himself with black causes. Id. at 157-58. The defendant's central allegation was that Judge Higginbotham's recent speech before a black history organization revealed his identification with civil rights cases. Id. at 159-60, 163. In addition to refusing disqualification on the grounds that background and associations could not be used to prove bias, the judge noted that dedication to upholding the law also could not be used to disqualify a judge. Id. at 159.

See also Brody v. President & Fellows of Harvard College, 664 F.2d 10, 11 (1st Cir. 1981) (fact that judge graduated from Harvard College does not disqualify him from hearing suit against Harvard), cert. denied, 455 U.S. 1027 (1982).

FN193. See Note, Meeting the Challenge: Rethinking Judicial Disqualification, 69 CALIF. L. REV. 1445, 1461 (1981) (simplistic allegations of bias based on implications from background rightfully given short shrift).

FN194. See infra notes 195-220 and accompanying text for a discussion of disqualification for an interest or relationship under § 455(a).

FN195. See supra note 12 for the text of 28 U.S.C. § 455.

FN196. See Senate Hearing, supra note 2, at 112 (relationship not specified under § 455(b) may raise question of impartiality under § 455(a)).

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FN197. See infra notes 207-20 and accompanying text for a discussion of cases in which § 455(a) disqualification was based on an interest or relationship.

FN198. See Patzner v. Burkett, 779 F.2d 1363, 1372 (8th Cir. 1985) (disqualification not mandated where defense attorney had served judge as law clerk more than a year before in light of circuit rule that prohibited law clerks from appearing before their judge within a year of their service); Hall v. Small Business Admin., 695 F.2d 175, 179 (5th Cir. 1983) (judge disqualified because current law clerk had interest in case).

FN199. United States v. Nobel, 696 F.2d 231, 235 (3d Cir. 1982) (judge disqualified for holding stock in corporate victim of fraud), cert. denied, 462 U.S. 1118 (1983).

FN200. 609 F.2d 1101 (5th Cir.), cert. denied, 449 U.S. 820 (1980).

FN201. Id. at 1110-12; see also Pepsico, Inc., 764 F.2d at 461 (disqualification required where judge indirectly sought employment in firm of attorney appearing before him).

FN202. 796 F.2d 796 (5th Cir. 1986).

FN203. Id. at 800-02. 28 U.S.C. § 455(b)(4) requires disqualification if a judge 'knows that he, individually or as a fiduciary . . . has a financial interest in the subject matter in controversy . . ..' The court held that the judge, who was a trustee of Loyola University, had 'constructive knowledge' of an interest in the case because he had attended a meeting at which financial information was disseminated that revealed the university's interest. 796 F.2d at 803. The court concluded that the judge's claimed forgetfulness could not provide a defense against disqualification under the objective standard of § 455(a) and thus held that the judge's recusal was necessary. Id. at 802-03. Cf. Davis v. Xerox, 811 F.2d 1293 (9th Cir. 1987) (if reasonable person would conclude that judge had no knowledge of interest at time rulings made, § 455(a) does not require that rulings be vacated).

FN204. See, e.g., Nobel, 696 F.2d at 235 (disqualification depends on appearance of bias); Hall v. Small Business Admin., 695 F.2d 175, 178 (5th Cir. 1983) (inappropriate under § 455(a) to inquire into actual bias of judge).

FN205. See, e.g., United States v. Story, 716 F.2d 1088, 1090-91 (6th Cir. 1983) (personal bias charged but court addressed as real issue whether judge should be disqualified for prior association with charity which was victim of crime).

FN206. See Nobel, 696 F.2d at 234 (question of whether judge is disqualified for financial interest in corporate victim of crime is a question of law).

FN207. 754 F.2d 1153 (5th Cir. 1985), cert. denied, 106 S. Ct. 277 (1985).

FN208. Id. at 1158-59.

FN209. Id. at 1164-65.

FN210. Id. at 1165.

FN211. Id. at 1166.

FN212. Id.

FN213. Id.

FN214. The question whether a personal relationship with the victim of a crime constitutes a disqualifying relationship

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is not settled. Compare United States v. Nobel, 696 F.2d 231, 235-36 (3d Cir. 1982) (concern for maintaining public confidence in judicial integrity, which 'depends on a belief in the impersonality of judicial decisionmaking,' requires disqualification of judge with financial interest in corporate victim of crime), cert. denied, 462 U.S. 1118 (1983) with United States v. Sellers, 566 F.2d 884, 887 (4th Cir. 1977) (fact that judge owned stock in bank that was victim of robbery did not create reasonable apprehension that judge would be partial).

FN215. 754 F.2d at 1166.

FN216. Id.

FN217. 779 F.2d 1191 (7th Cir. 1985), cert. denied, 106 S. Ct. 1490 (1986).

FN218. Id. at 1200.

FN219. Id. at 1201.

FN220. Compare id. at 1201-02 (disqualification not required of judge who, as Attorney General, allegedly focused on defendant as organized crime figure) with Bradshaw v. McCotter, 785 F.2d 1327, 1329 (5th Cir. 1986) (habeas corpus relief granted because appellate judge, who had been state prosecuting attorney at time party was prosecuted and whose name appeared on state's brief, should have disqualified himself even though name appeared on brief as a matter or protocol and judge had not participated in prosecution), modified on reh'g, 796 F.2d 100, 101 (5th Cir. 1986) (although judge disqualified, habeas corpus relief not granted because judge's vote on appeal not controlling). See also Idaho v. Freeman, 507 F. Supp. 706, 731-33 (D. Idaho 1981) (in case in which plaintiffs sought extension of deadline for ratification of ERA, disqualification on basis of judge's holding responsible office in Mormon Church, which had taken stand and engaged in lobbying efforts against ERA, denied by challenged judge on grounds that he had never participated in anti-ERA lobbying nor made his personal position known).

FN221. Cf. Moore, Appellate Review of Judicial Disqualification Decisions in the Federal Courts, 35 Hastings L.J. 829, 846 (1984) (disqualification on the basis of bias or prejudice inherently subjective, requiring different treatment on review).

FN222. 28 U.S.C. § 455(a) (1982).

FN223. Id. § 455(b).

FN224. See supra notes 14-20 and accompanying text for a discussion of the statutory provisions mandating disqualification for interest or relationship.

FN225. Id.

FN226. See supra notes 195-220 and accompanying text for a discussion of disqualification under § 455(a) on the basis of interest or relationship. See also Aetna Life Ins. Co. v. Lavoie, 106 S. Ct. 1580, 1587 (1986) (reviewing court not required to decide whether judge is actually biased by interest but only whether normal average judge would be biased in circumstances).

FN227. See Pepsico, Inc. v. McMillen, 764 F.2d 458, 461 (7th Cir. 1985) (disqualification mandated where judge in negotiation for employment with law firm or party appearing before him); United States v. Nobel, 696 F.2d 231, 235-36 (3d Cir. 1982) (court adopted rule that judge is disqualified for financial interest in victim of crime), cert. denied, 462 U.S. 1118 (1983).

FN228. See supra notes 109-93 and accompanying text for a discussion of judicial requirements for disqualification for bias or prejudice.

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FN229. See, e.g., Roberts v. Bailar, 625 F.2d 125, 129 (6th Cir. 1980) (remark undisputedly made by judge must be evaluated on objective standard that asks whether a reasonable person with knowledge of all the facts would doubt judge's impartiality).

FN230. See Hall v. Small Business Admin., 696 F.2d 175, 179 (5th Cir. 1983) (inquiry into the state of mind of a judge not part of the objective test); Roberts v. Bailar, 625 F.2d at 129-30 (judge's statement regarding his assessment of supervisor's character in employment discrimination suit disqualified him under the objective standard; court did not consider and explicitly rendered no opinion regarding existence of actual bias).

FN231. See supra note 30 and accompanying text for a discussion of the elimination of the duty to sit.

FN232. Id.

FN233. See, e.g., Roberts v. Bailar, 625 F.2d at 129-30 (judge's statement assessing character of key person in lawsuit disqualifies judge); Nicodemus v. Chrysler Corp., 596 F.2d 152, 155-56 (6th Cir. 1979) (outburst against party unsupported by record grounds for disqualification); United States v. Thompson, 483 F.2d 527, 529 (3d Cir. 1973) (fixed opinion on sentencing disqualified judge).

FN234. 28 U.S.C. § 144 (1982). See supra notes 35-43 and accompanying text for a discussion of § 144 requirements.

FN235. Berger v. United States, 225 U.S. 22, 36 (1921).

FN236. Id.

FN237. See supra notes 69-73 and accompanying text for a discussion of the standard of proof under § 144.

FN238. See supra notes 109-94 and accompanying text for a discussion of the judicial limitations on disqualification.

FN239. To determine the legal sufficiency of a § 144 affidavit, a judge must consider whether it is definite enough in its pleadings, whether the kind of prejudice it alleges is judicially recognized as grounds for disqualification, and, if so, whether the facts it alleges would convince a reasonable person that the judge is biased. See supra note 69 for the three-part test for legal sufficiency generally applied by the courts.

FN240. United States v. Balistrieri, 779 F.2d 1191, 1202 (7th Cir. 1985), cert. denied, 106 U.S. 1490 (1986); see also Hall v. Small Business Admin., 695 F.2d 175, 179 (5th Cir. 1983) (judge must evaluate disqualification motion from perspective of reasonable person with knowledge of all objective facts); Potashnick v. Port City Constr. Co., 609 F.2d 1101, 1111 (5th Cir.) (disqualification required if reasonable person with knowledge of circumstances would harbor doubts about judge's impartiality), cert. denied, 449 U.S. 820 (1980); Blizard v. Frechette, 601 F.2d 1217, 1220 (1st Cir. 1979) (disqualification required if reasonable person would have factual grounds for doubting judge's impartiality).

FN241. See, e.g., In re International Business Machs. Corp., 618 F.2d 923, 927 (2d Cir. 1980) (intolerable to judicial system to allow challenged judge to terminate inquiry of prejudice until ultimate review on merits).

FN242. See Comment, Disqualification of Federal District Judges--Problems and Proposals, 7 SETON HALL L. REV. 612, 633-36 (1976) (automatic disqualification upon filing of motion recommended as efficient method that protects judges' reputations since it avoids discussion of actual or apparent bias); Note, Disqualification of Federal District Judges for Bias Under 28 U.S.C. Section 144 and Revised Section 455, 45 FORDHAM L. REV. 139, 159-63 (1976) (disqualification by peremptory challenge 'best way to rectify the existing deficiencies' in disqualification process).

FN243. See Note, supra note 193, at 1471-72 (judge-shopping most common abuse of California peremptory challenge provision).

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FN244. Id. at 1472-73 (delays and judicial waste in California results from peremptory challenge rule).

FN245. See Senate Hearing, supra note 2, at 7-8, 13 (S. 1886, introduced by Senator Bayh, allowed one peremptory challenge per side).

FN246. To make transfer of disqualification decisions mandatory would require amendment of the current statute, 28 U.S.C. § 455, which explicitly places the responsibility for disqualification on the challenged judge. See supra note 12 for the text of § 455. See also Comment, supra note 75, at 266 n.172, for a discussion of creative ways to circumvent the current requirement that judges disqualify themselves.

FN247. See Bloom, supra note 55, at 697, 706 (decision should be referred to another district court judge to enhance appearance of impartiality); Redish & Marshall, supra note 1, at 503 n.180 (to make right to non-biased adjudicator meaningful, parties should be afforded opportunity to present their case for disqualification before judge other than the person challenged); Comment, supra note 75, at 265-67 (courts should encourage transfer at discretion of challenged judge); Note, supra note 193, at 1484 ('mini-hearing review' of affidavits on district court level best solution to problems with disqualification process).

FN248. See Note, supra note 193, at 1484 (refer disqualification questions to presiding judge to decide solely on basis of affidavits).

FN249. See Comment, supra note 75, at 265-66 (transfer policy could be used for delay and could be disruptive in states or territories with only one or two federal judges).

FN250. See Bloom, supra note 55, at 697 (administrative burden may be worth paying to enhance appearance of judicial impartiality); Comment, supra note 75, at 265-66 (transfers would produce more disinterested decision and spare judge embarrassment of ruling; best to make practice of transferring except where delay or disruption substantial).

FN251. See Redish & Marshall, supra note 1, at 504 n.180 (to allow litigant to go through trial with biased judge is at odds with Supreme Court pronouncement that due process affords right to impartial judge at all stages of process); see also Moore, supra note 226, at 851 (permitting trial before judge who is or appears to be biased constitutes enormous encroachment of fundamental value of impartiality).

FN252. See, e.g., Roberts v. Bailar, 625 F.2d 125, 126 (6th Cir. 1980) (remanded for new trial because disqualification required under § 455); Potashnick v. Port City Constr. Co., 609 F.2d 1101, 1104 (5th Cir.) (reversed because judge should have disqualified himself; remanded for new trial before different judge).

FN253. See, e.g., United States v. Harrelson, 754 F.2d 1153 (5th Cir.) (court faced with whether to grant new trial to person convicted of murdering district court judge), cert. denied, 106 S. Ct. 599 (1985).

FN254. Section 144 contains a timeliness requirement. See supra note 37 for discussion of the timeliness requirement under § 144. Section 455 does not contain any such requirement. In SCA Services, Inc. v. Morgan, 557 F.2d 110, 117 (7th Cir. 1977) (per curiam) the Seventh Circuit held that no time limits may be imposed. Since then, the Seventh Circuit has questioned, but not altered, this ruling. See Union Carbide Corp. v. U.S. Cutting Serv., Inc., 782 F.2d 710, 716 (7th Cir. 1986) (Morgan decision repeatedly questioned, recently undermined by court of appeals; reconsideration unnecessary here). Several courts have rejected the Morgan analysis and imposed a timeliness requirement on § 455. See Chitimacha Tribe v. Harry L. Laws Co., 690 F.2d 1157, 1164 n.3 (5th Cir. 1982) (§§ 144 and 455 both require timely motion), cert. denied, 464 U.S. 814 (1983); In re International Business Machs. Corp., 618 F.2d 923, 932 (2d Cir. 1980) (court can impose timeliness requirement despite lack of statutory provision). Timeliness may also be encouraged by treating failure to move for disqualification at an appropriate moment as an implicit waiver, as the Third Circuit did in United States v. Nobel, 696 F.2d 231, 237 (3d Cir. 1982), cert. denied, 462 U.S. 1118 (1983).

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FN255. 28 U.S.C. § 1291 (1982). A decision is considered final only when it 'ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.' Firestone Tire & Rubber Co. v. Risjord, 449 U.S. 368, 373-74 (1981) (quoting Coopers & Lybrand v. Livesay, 437 U.S. 463, 467 (1978) (quoting Catlin v. United States, 324 U.S. 229, 233 (1945)).

Courts seldom review disqualification issues under the exception to the finality rule provided by federal law, 28 U.S.C. § 1292(b) (1982), which allows review prior to a decision on the merits only in narrowly circumscribed instances. Under § 1292(b), a district judge must certify an order asking for review and the appellate court must agree to hear the appeal. Id. The issue in question must involve 'a controlling question of law as to which there is substantial grounds for difference of opinion,' and where 'immediate appeal from the order may materially advance the utlimate termination of the litigation.' Id.

The certification process is seldom available for a disqualification motion grounded in either § 144, 455(b)(1) or 455(a), since such a motion generally hinges on interpretation of facts and is unlikely to present a question involving a controlling issue of law as to which there is substantial grounds for difference of opinion. See 13A C. WRIGHT, A MILLER & E. COOPER, FEDERAL PRACTICE AND PROCEDURE § 3553 at 659 (1984) (§ 1292(b) standard not often met in disqualification decisions).

Reviewed by certification has been employed occasionally. See, e.g., Davis v. Board of School Comm'rs, 517 F.2d 1044, 1047 (5th Cir. 1975) (review allowed under 28 U.S.C. § 1292(b) to determine whether prejudice against attorney disqualifies under § 144), cert. denied, 425 U.S. 944 (1976).

Another means for interlocutory review is the collateral order rule, a common law rule that an interlocutory order is immediately appealable if it is 'in that small class which finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated.' Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 546 (1949). Appellate courts have proved unwilling to exercise this common law doctrine to review disqualification motions. See, e.g., In re Corrugated Container Antitrust Litig., 614 F.2d 958, 960-61 (5th Cir.) (disqualification motions not reviewable under collateral order doctrine because fully reviewable on appeal from final judgment), cert. denied, 449 U.S. 888 (1980); accord United States v. Gregory, 656 F.2d 1132, 1136 (5th Cir. 1981); United States v. Washington, 573 F.2d 1121, 1122 (9th Cir. 1978). But see Moore, supra note 226, at 862-63 (arguments supporting review for mandamus also support review under collateral order rule; review under collateral order rule preferable because mandamus may impose higher standard).

FN256. See, e.g., Pepsico, Inc. v. McMillen, 764 F.2d 458, 460 (7th Cir. 1985) (mandamus appropriate where judge fails to step down when required to by § 455(a)); In re United States, 666 F.2d 690, 694 (1st Cir. 1981) (mandamus jurisdiction appropriate where issue is judicial disqualification); In re International Business Machs. Corp., 618 F.2d 923, 927 (2d Cir. 1980) (court has power to issue writ of mandamus when disqualification has been denied). See generally Berger, The Mandamus Power of the United States Courts of Appeals: A Complex and Confused Means of Appellate Control, 31 BUFF. L. REV. 37 (1982). See also Moore, supra note 221, at 839-54 (analysis of mandamus review of disqualification denials).

FN257. Work v. United States ex rel. Rives, 267 U.S. 175, 177 (1925).

FN258. Roche v. Evaporated Milk Ass'n, 319 U.S. 21, 26 (1943). Courts have the power to issue writs of mandamus under a statutory provision which allows courts to 'issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.' 28 U.S.C. § 1651(a) (1982).

FN259. Will v. United States, 389 U.S. 90, 95 (1967).

FN260. Work, 267 U.S. at 177.

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FN261. Roche, 319 U.S. at 27. See also Moore, supra note 221, at 842-43 (analysis of use of mandamus to direct judges).

FN262. La Buy v. Howes Leather Co., 352 U.S. 249, 257 (1957); Work, 267 U.S. at 177-78.

FN263. See United States v. Harrelson, 754 F.2d 1153, 1165 (5th Cir.) (disqualification decision committed to sound discretion of trial judge; denial of disqualification will be overturned only if discretion is abused); cert. denied, 106 S. Ct. 599 (1985); United States v. Nobel, 696 F.2d 231, 234 (3rd Cir. 1982) (accepted standard for review of disqualification denial is abuse of discretion), cert. denied, 462 U.S. 1118 (1983); accord In re Ibrahim Khan, 751 F.2d 162, 165 (6th Cir. 1984); In re Federal Skywalk Cases, 680 F.2d 1175, 1183 (8th Cir.), cert. denied, 459 U.S. 988 (1982).

FN264. Act of June 25, 1948, ch. 646, § 455, 62 Stat. 908. See supra note 28 for text of this predecessor section.

FN265. 28 U.S.C. § 455(a). See supra note 12 for text of § 455(a).

FN266. House Report, supra note 4, at 6355.

FN267. Id.

FN268. See infra notes 270-75 and accompanying text for cases applying abuse of discretion standard.

FN269. See, e.g., McKenzie Constr., Inc. v. Maynard, 758 F.2d 97, 100 (3d Cir. 1985) (scrutiny of record, which yielded no evidence of bias, decisive factor in upholding decision); United States v. Porter, 701 F.2d 1158, 1166 (6th Cir.) (court's scrutiny of record showed no evidence of personal prejudice), cert. denied, 464 U.S. 1007 (1983).

FN270. 779 F.2d 1191 (7th Cir. 1985), cert. denied, 106 S. Ct. 1490 (1986).

FN271. 779 F.2d at 1203. The court did not review the motion on the basis of § 455(a); it held that this section could not be raised on post-trial review. Id. at 1205.

FN272. Id. at 1203.

FN273. Id. at 1203.

FN274. See infra notes 276-77 and accompanying text for the House statement on the standard of review.

FN275. The Balistrieri decision cited no cases in support of its holding. See Balistrieri, 779 F.2d at 1202-03. Other courts have consistently applied the abuse of discretion standard. See United States v. Nobel, 696 F.2d 231, 234 (3d Cir. 1982) (abuse of discretion is accepted standard), cert. denied, 462 U.S. 1118 (1983).

FN276. House Report, supra note 4, at 6355.

FN277. 28 U.S.C. § 455(b) & (e).

FN278. See supra notes 222-33 and accompanying text for a discussion of the decision-making process for disqualification determinations under section 455(a).

FN279. 28 U.S.C. § 455(a).

FN280. Kerr v. United States Dist. Ct., 426 U.S. 394, 403 (1976).

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FN281. In re Corrugated Container Antitrust Litig., 614 F.2d 958, 962 (5th Cir.), cert. denied, 449 U.S. 888 (1980). The Corrugated Container court also considered the merits of the claim for disqualification, 614 F.2d at 963-68, and refused to issue a writ on the merits. Id. at 968. The court apparently modified its position later. See United States v. Gregory, 656 F.2d 1132, 1136-37 (5th Cir. 1981) (Fifth Circuit followed Corrugated Container in holding that review not available under collateral order rule because claim was reviewable on appeal; ignored this argument in considering whether to issue a writ of mandamus).

FN282. See In re United States, 666 F.2d 690, 694 (1st Cir. 1981) (public confidence in judiciary requires that substantial claim of bias be addressed at earliest possible opportunity) (citing In re Union Leader Corp., 292 F.2d 381, 384 (1st Cir.), cert. denied, 368 U.S. 927 (1961)); In re International Business Machs. Corp., 618 F.2d 923, 927 (2d Cir. 1980) (intolerable to judicial system to delay consideration of disqualification denial to final appeal).

The Seventh Circuit has settled the issue of whether appeal provides an adequate remedy by denying the post-trial appealability of § 455(a) disqualification motions and making mandamus the only remedy. United States v. Balistrieri, 779 F.2d 1191, 1205 (7th Cir. 1985), cert. denied, 106 U.S. 1490 (1986).

FN283. Bankers Life and Casualty Co. v. Holland, 346 U.S. 379, 384 (1953); see also United States v. Gregory, 656 F.2d 1132, 1136 (5th Cir. 1981) (question of disqualification reviewable on mandamus but party seeking writ must prove 'clear and indisputable right' to writ).

FN284. See La Buy v. Howes Leather Co., 352 U.S. 256, 257 (1957) (writ granted where judge clearly abused discretion in referring case to master); Pepsico, Inc. v. McMillen, 764 F.2d 458, 461 (7th Cir. 1985) (writ granted to disqualify judge in circumstances where reasonable people could disagree whether disqualification was mandated).

FN285. Will v. Calvert Fire Ins. Co., 437 U.S. 655, 665-66 & n.7 (1978) (mere showing of abuse of discretion not sufficient for issuance of writ of mandamus) (Rehnquist, J.) (plurality opinion).

FN286. In re United States, 666 F.2d at 694. See also Union Carbide Corp. v. U.S. Cutting Serv., Inc., 782 F.2d 710, 712 (7th Cir. 1986) (writ will be denied in frivolous and even routine cases).

FN287. In re International Business Machs. Corp., 618 F.2d at 934. The clear and indisputable right requirement arguably puts a higher burden on the litigants seeking mandamus than on those seeking final review and leaves open the possibility that the issue could be raised again on final review. Moore, supra note 226, at 854 & n.154 & 155.

FN288. See Union Carbide Corp. v. United States Cutting Serv., Inc., 782 F.2d 710, 712 (7th Cir. 1986) (refusal to disqualify in the face of a substantial challenge casts shadow over individual litigation and over integrity of federal judicial process which should be dispelled as soon as possible by authoritative judgment; therefore, court should be liberal in use of writ of mandamus to insure timely review).

FN289. See supra notes 256-62 for a discussion of the use of a writ of mandamus to assure the integrity of the disqualification process.

FN290. See supra notes 246-50 for a discussion of the proposed transfer of the disqualification decision to an adjudicator other than the challenged judge.

FN291. See supra notes 251-55 for a discussion of the proposal for immediate and comprehensive appellate review of a disqualification motion.

FN292. See supra note 57, notes 93-97 and note 108 and accompanying text for a discussion of the balance struck by Congress in § 455(a).

FN293. See supra notes 109-241 and accompanying text for a copy of judicial interpretation and application of §

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455(a).

FN294. See supra notes 76-100 for a discussion of the Seventh Circuit's opinion in Unites States v. Balistrieri, 779 F.2d 1191 (7th Cir. 1985), cert. denied, 106 S. Ct. 1490 (1986).

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Chapter 64

CHANGE OF JUDGE BECAUSE OF BIAS, PREJUDICE OR INTEREST

[Relating to Federal Rules of Civil Procedure, Rule 63]

Analysis

	Sections
A. Personal Bias or Prejudice	**5151–5160**
B. Interest or Relationship	**5161–5170**

A. PERSONAL BIAS OR PREJUDICE

Sec.
5151. Affidavit of Bias or Prejudice—General Form.
5152. —— Another Form.
5153. —— Recitation of Specific Facts and Reasons for Belief That Judge Is Biased or Prejudiced.
5154. Allegation of Affidavit Stating Cause of Delay in Filing.
5155. —— Another Form.
5156. Certificate of Counsel Supporting Affidavit.
5157. —— Another Form.
5158. Certification of Disqualification Upon Filing of Affidavit of Prejudice.
5159. Order Designating Another Judge.
5160. —— Another Form.

B. INTEREST OR RELATIONSHIP

5161. Order of Judge Disqualifying Oneself Because of Previous Relationship.
5162. Order of Judge Disqualifying Oneself Because of Relationship.
5163. Affidavit of Interest of Judge—General Form.
5164. Motion for Judge's Disqualification Because of Interest.

WESTLAW Electronic Research

See WESTLAW Electronic Research Guide preceding the Summary of Contents.

Library References:

C.J.S. Judges §§ 35–38, 62–107, 108, 119 et seq., 161 et seq.
West's Key No. Digests, Judges ⇐13 et seq., 21, 25, 39 et seq., 41 et seq., 45, 46, 49.

A. PERSONAL BIAS OR PREJUDICE

§ 5151. Affidavit of Bias or Prejudice—General Form

[*Title of Court and Cause*]

[*Venue*]

———, being duly sworn, deposes and says:

1. I am the defendant [*or* plaintiff] in the above-entitled cause.

2. The Honorable ———, Judge of the court in which this action was commenced and is now pending, and before whom it is to be tried or heard, has a personal bias [*or* prejudice *or* bias and prejudice] against me [*or* in favor of ———, the ——— (*opposing party*)]. The facts and reasons for such belief are as follows: ——— [*state facts and reasons for belief that bias or prejudice exists*].

Wherefore affiant prays that the Honorable ——— proceed no further in this cause and that another judge be designated in this cause.

Dated: ———

———
Defendant [*or* Plaintiff]

[*Jurat*]

COMMENT

Analysis

1. **Governing Rule and Statutes**
2. **Time of Objection on Ground of Personal Bias or Prejudice**
3. **Affidavit and Certificate Requirements for Disqualification on Ground of Personal Bias or Prejudice**
4. **Disqualification of Judge for Interest**

1. Governing Rule and Statutes

Rule 63 provides:

> If a trial or hearing has been commenced and the judge is unable to proceed, any other judge may proceed with it upon certifying familiarity with the record and determining that the proceedings in

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 339

the case may be completed without prejudice to the parties. In a hearing or trial without a jury, the successor judge shall at the request of a party recall any witness whose testimony is material and disputed and who is available to testify again without undue burden. The successor judge may also recall any other witness.

The Advisory Committee Note explains the 1991 amendment as follows:

The revision substantially displaces the former rule. The former rule was limited to the disability of the judge, and made no provision for disqualification or possible other reasons for the withdrawal of the judge during proceedings. In making provision for other circumstances, the revision is not intended to encourage judges to discontinue participation in a trial for any but compelling reasons. Cf. *United States v. Lane*, 708 F.2d 1394, 1395–1397 (9th Cir.1983). Manifestly, a substitution should not be made for the personal convenience of the court, and the reasons for a substitution should be stated on the record.

The former rule made no provision for the withdrawal of the judge during the trial, but was limited to disqualification after trial. Several courts concluded that the text of the former rule prohibited substitution of a new judge prior to the points described in the rule, thus requiring a new trial, whether or not a fair disposition was within reach of a substitute judge. *E.g., Whalen v. Ford Motor Credit Co.*, 684 F.2d 272 (4th Cir.1982, en banc), *cert. denied*, 459 U.S. 910 (1982) (jury trial); *Arrow–Hart, Inc. v. Philip Carey Co.*, 552 F.2d 711 (6th Cir.1977) (non-jury trial). *See generally* Comment, *The Case of the Dead Judge: Fed.R.Civ.P. 63: Whalen v. Ford Motor Credit Co.*, 67 MINN.L.REV. 827 (1983).

The increasing length of federal trials has made it likely that the number of trials interrupted by the disability of the judge will increase. An efficient mechanism for completing these cases without unfairness is needed to prevent unnecessary expense and delay. To avoid the injustice that may result if the substitute judge proceeds despite unfamiliarity with the action, the new Rule provides, in language similar to Federal Rule of Criminal Procedure 25(a), that the successor judge must certify familiarity with the record and determine that the case may be completed before that judge without prejudice to the parties. This will necessarily require that there be available a transcript or a videotape of the proceedings prior to substitution. If there has been a long but incomplete jury trial, the prompt availability of the transcript or videotape is crucial to the effective use of this rule, for the jury cannot long be held while an extensive transcript is prepared without prejudice to one or all parties.

The revised text authorizes the substitute judge to make a finding of fact at a bench trial based on evidence heard by a different judge. This may be appropriate in limited circumstances. First, if a witness has become unavailable, the testimony recorded at trial can be considered by the successor judge pursuant to F.R.Ev. 804, being equivalent to a recorded deposition available for use at trial pursuant

to Rule 32. For this purpose, a witness who is no longer subject to a subpoena to compel testimony at trial is unavailable. Secondly, the successor judge may determine that particular testimony is not material or is not disputed, and so need not be reheard. The propriety of proceeding in this manner may be marginally affected by the availability of a videotape record; a judge who has reviewed a trial on videotape may be entitled to greater confidence in his or her ability to proceed.

The court would, however, risk error to determine the credibility of a witness not seen or heard who is available to be recalled. Cf. *Anderson v. City of Bessemer City NC*, 470 U.S. 564, 575 (1985); *Marshall v. Jerrico Inc*, 446 U.S. 238, 242 (1980). See also *United States v. Radatz*, 447 U.S. 667 (1980).

With respect to the disqualification of a judge on the ground of bias or prejudice, 28 U.S.C.A. § 144 provides as follows:

Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding.

The affidavit shall state the facts and the reasons for the belief that bias or prejudice exists, and shall be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, or good cause shall be shown for failure to file it within such time. A party may file only one such affidavit in any case. It shall be accompanied by a certificate of counsel of record stating that it is being made in good faith.

With respect to disqualification of a judge for interest, 28 U.S.C.A. § 455 provides as follows:

(a) Any justice, judge, or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.

(b) He shall also disqualify himself in the following circumstances:

(1) Where he has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;

(2) Where in private practice he served as lawyer in the matter in controversy, or a lawyer with whom he previously practiced law served during such association as a lawyer concerning the matter, or the judge or such lawyer has been a material witness concerning it;

(3) Where he has served in governmental employment and in such capacity participated as counsel, adviser or material witness concerning the proceeding or expressed an opinion concerning the merits of the particular case in controversy;

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 340

(4) He knows that he, individually or as a fiduciary, or his spouse or minor child residing in his household, has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding;

(5) He or his spouse, or a person within the third degree of relationship to either of them, or the spouse of such a person:

(i) Is a party to the proceeding, or an officer, director, or trustee of a party;

(ii) Is acting as a lawyer in the proceeding;

(iii) Is known by the judge to have an interest that could be substantially affected by the outcome of the proceeding;

(iv) Is to the judge's knowledge likely to be a material witness in the proceeding.

(c) A judge should inform himself about his personal and fiduciary financial interests, and make a reasonable effort to inform himself about the personal financial interests of his spouse and minor children residing in his household.

(d) For the purposes of this section the following words or phrases shall have the meaning indicated:

(1) "proceeding" includes pretrial, trial, appellate review, or other stages of litigation;

(2) the degree of relationship is calculated according to the civil law system;

(3) "fiduciary" includes such relationships as executor, administrator, trustee, and guardian;

(4) "financial interest" means ownership of a legal or equitable interest, however small, or a relationship as director, adviser, or other active participant in the affairs of a party, except that:

(i) Ownership in a mutual or common investment fund that holds securities is not a "financial interest" in such securities unless the judge participates in the management of the fund;

(ii) An office in an educational, religious, charitable, fraternal, or civic organization is not a "financial interest" in securities held by the organization;

(iii) The proprietary interest of a policyholder in a mutual insurance company, of a depositor in a mutual savings association, or a similar proprietary interest, is a "financial interest" in the organization only if the outcome of the proceeding could substantially affect the value of the interest;

(iv) Ownership of government securities is a "financial interest" in the issuer only if the outcome of the proceeding could substantially affect the value of the securities.

(e) No justice, judge, or magistrate shall accept from the parties to the proceeding a waiver of any ground for disqualification enumerated in subsection (b). Where the ground for disqualification arises only under subsection (a), waiver may be accepted provided it is preceded by a full disclosure on the record of the basis for disqualification.

(f) Notwithstanding the preceding provisions of this section, if any justice, judge, magistrate, or bankruptcy judge to whom a matter has been assigned would be disqualified, after substantial judicial time has been devoted to the matter, because of the appearance or discovery, after the matter was assigned to him or her, that he or she individually or as a fiduciary, or his or her spouse or minor child residing in his or her household, has a financial interest in a party (other than an interest that could be substantially affected by the outcome), disqualification is not required if the justice, judge, magistrate, bankruptcy judge, spouse or minor child, as the case may be, divests himself or herself of the interest that provides the grounds for the disqualification.

2. Time of Objection on Ground of Personal Bias or Prejudice

Under 28 U.S.C.A. § 144 an affidavit of prejudice must be timely. The provision that it be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, in the absence of a showing of good cause for failure to file it by that time, no longer can be applied, since terms of court were abolished in 1963. A party requesting the disqualification of a judge must now proceed with due diligence. A request to disqualify can be dismissed if the party has unduly delayed in filing the affidavit. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3551.

3. Affidavit and Certificate Requirements for Disqualification on Ground of Personal Bias or Prejudice

When a party seeks to disqualify a judge for personal bias or prejudice under 28 U.S.C.A. § 144, the judge must examine the affidavit or declaration and accompanying certificate to determine whether they are timely and legally sufficient. Only if the documents meet strict scrutiny does disqualification become mandatory. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3551. If the affidavit or declaration is presented in time and in proper form, the court must take as true the facts set out in the affidavit or declaration. Only questions of law are presented and there can be no dispute about the truth or falsity of the allegations of the affidavit or declaration. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3551. See also Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3542 with respect to what constitutes personal bias.

The affidavit or declaration must state facts and reasons for the belief that bias exists. The affidavit or declaration must be definite as to the time, place, persons, and circumstances. Mere conclusory allegations are not sufficient. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3551.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 341

Section 144 permits the filing of only one affidavit or declaration of prejudice in any case. However, a judge is under a continuing duty to disqualify himself or herself at any time the judge is satisfied that he or she is disqualified under § 455.

The affidavit or declaration must be accompanied by a certificate of counsel stating that the affidavit is made in good faith. The certificate must be signed by counsel of record, who must be an attorney admitted to the bar of the particular court. While § 144 appears to contemplate that the certificate attest to the good faith of the affiant or declarant, some courts have ruled that the certificate must state that counsel is acting in good faith. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3551.

See Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d §§ 3542–3549 with respect to grounds for disqualification.

An unsworn declaration under penalty of perjury may be used in lieu of an affidavit. 28 U.S.C.A. § 1746. The form for an unsworn declaration under Section 1746 executed within the United States is as follows: "I declare [or certify, verify, or state] under penalty of perjury that the foregoing is true and correct. Executed on [*date*]."

However, local practice should be consulted. Some courts may still prefer affidavits to declarations under penalty of perjury. See Moynihan, *Affidavit Evidence*, 14 Litigation 43 (Spring 1988).

4. Disqualification of Judge for Interest

28 U.S.C.A. § 455 is directed to the judges themselves and says nothing about procedure. Although no action by a party is required to invoke the provision of the statute, a party can suggest to the judge that grounds for disqualification exist. When a judge learns that grounds for his or her disqualification exist under § 455, the judge should disqualify himself or herself regardless of the source of the information. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3550.

There can be waiver under § 455(a) only if the facts of the basis of the disqualification have been fully disclosed by the judge on the record. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3552.

§ 5152. Affidavit of Bias or Prejudice—Another Form

[*Title of Court and Cause*]

[*Venue*]

_____, being first duly sworn, upon oath deposes and says: _____ is one of the defendants in the case of _____ against _____, numbered _____, now pending in the United States District Court for the _____ District of _____. _____ believes and charges that his honor, Judge _____, has a personal bias and prejudice against _____ and the codefendants _____ and _____, and each of them, and in favor of the government, by reason of which the judge is unable impartially to exercise his

functions as judge in this cause. By reason of this personal bias and prejudice neither of these defendants can have a fair and impartial trial before him. The grounds for the defendant's beliefs are as follows:

The defendants state upon information and belief that Hon. _____, in the city of _____, after the organization of the United States District Court for the _____ District of _____, created and organized pursuant to the act of Congress of _____, made addresses before certain civic clubs and churches of that city on the subject of law enforcement. In all these addresses he told his audiences in substance, and through them the general public, that he intended to bear down with heavy hands on all offenders against federal criminal laws. During the course of his address before one of the clubs, namely, the _____ club, on or about [*date*], he stated that the higher the law violator's collar and the whiter his shirt, the longer his sentence would be in his court, and that, the longer his list of witnesses, the heavier his sentence would be.

_____ has been informed that Hon. _____, has expressed a willingness to assist the _____ officers in apprehending this affiant in the commission of a violation of the _____ law, by permitting prisoners of the United States government to be used as undercover agents for the purpose of obtaining evidence against this affiant, and this affiant has been further informed that Hon. _____, did, at least upon one occasion, permit a prisoner of the United States government to be placed in the custody of _____ officers, for the purpose of using the prisoner in the obtaining of evidence against this affiant.

Affiant further states that on [*date*], he was tried before the court upon a charge of violating the _____ laws, and was in the cause acquitted. However, during the progress of the trial, one of the state's witnesses testified to a state of facts which the district attorney contended was contradictory to sworn written statement, furnished by the witness to the district attorney; and over the objections of the attorney for this affiant, his honor, _____, judge of the court, permitted the district attorney to conduct a rigid cross-examination of the state's own witness. And Hon. _____, judge of the court, did at that time and in open court, state in substance that the witness had been tampered with, and from his demeanor cast reflection upon this affiant, and caused this affiant and his friends to believe that Hon. _____ believed that this affiant had in some manner stifled the testimony of the witness. And the court did at that time, in the presence of the jury, order the witness held for perjury, and did instruct the district attorney to file perjury charges against the witness; it was apparent from

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 342

the testimony that the witness had been tampered with by some one.

Affiant further states that he had prior to the trial, and during the trial, conducted himself properly, and was without fault and did not have anything to do with the witness whatsoever.

Affiant further states that his son, _____, one of the defendants named in the indictment with this affiant, was tried before his honor, _____, and that on [*date*], in the case of United States against _____, No. _____ in that court, passed sentence upon _____, and while passing the sentence the court stated in substance, as this affiant is informed and believes, as follows: "The _____ tribe seem to believe that they have the privilege as a matter of right to sell _____, but it has got to stop in the _____ district, if I can prevent it."

Affiant further states that he is informed that Hon. _____ further stated, or commented upon the fact, that this affiant, father of _____, had been tried before him, and that an uncle of _____ had been tried and convicted before him.

Affiant further states that on [*date*], this affiant obtained the attached affidavit of _____, which supports the statements made by this affiant upon information and belief, as to the fact that his honor, _____, had interested himself in obtaining evidence against this affiant.

Affiant further states that on several occasions he has requested his attorneys to prepare and file application to disqualify his honor, _____, from trying this affiant or either of his sons, _____ and _____, but that his attorneys have disagreed with this affiant, until [*date*], when this affiant received new information, which was imparted to attorneys for this affiant and set out above. The information could not have been obtained at an earlier date, as it was not known to any of the parties defendant that it existed until this affiant was so informed as stated above.

Affiant further states that he believes that Hon. _____ has impressions or prejudices in his mind and against this defendant, and against his family, including his codefendants, sons of this affiant, which it would take evidence to remove, and that he cannot have a fair and impartial trial before Hon. _____, and that he is entitled to have a trial before another United States judge.

Subscribed and sworn to before me this [*date*]

_____

Notary Public
My Commission expires _____

COMMENT

An unsworn declaration under penalty of perjury may be used in lieu of an affidavit. 28 U.S.C.A. § 1746. The form for an unsworn declaration under Section 1746 executed within the United States is as follows: "I declare [or certify, verify, or state] under penalty of perjury that the foregoing is true and correct. Executed on [*date*]."

However, local practice should be consulted. Some courts may still prefer affidavits to declarations under penalty of perjury. See Moynihan, *Affidavit Evidence*, 14 Litigation 43 (Spring 1988).

See § 5151, Comment.

§ 5153. Affidavit of Bias or Prejudice—Recitation of Specific Facts and Reasons for Belief That Judge Is Biased or Prejudiced

[*Venue*]

Petitioners [*defendants*] represent that they jointly and severally believe that Judge _____ has a personal bias and prejudice against certain of the defendants, namely, _____, _____, and _____, defendants in this cause, and impleaded with _____ and _____, defendants in this case. The grounds for the petitioners' beliefs are the following facts:

[*State specific facts showing bias or prejudice*]

_____

Subscribed and sworn to before me this [*date*].

_____

Notary Public
My commission expires [*date*].

COMMENT

An unsworn declaration under penalty of perjury may be used in lieu of an affidavit. 28 U.S.C.A. § 1746. The form for an unsworn declaration under Section 1746 executed within the United States is as follows: "I declare [or certify, verify, or state] under penalty of perjury that the foregoing is true and correct. Executed on [*date*].

However, local practice should be consulted. Some courts may still prefer affidavits to declarations under penalty of perjury. See Moynihan, *Affidavit Evidence*, 14 Litigation 43 (Spring 1988).

See § 5151, Comment.

§ 5154. Allegation of Affidavit Stating Cause of Delay in Filing

Affiant further states that she did not file this or any affidavit of prejudice until this date for the reason that the first knowledge she had that Hon. _____ has a personal bias and prejudice

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 343

against her was on [*date*], and subsequent to that, and this affiant has filed this affidavit of prejudice at the first opportunity.

COMMENT

An unsworn declaration under penalty of perjury may be used in lieu of an affidavit. 28 U.S.C.A. § 1746. The form for an unsworn declaration under Section 1746 executed within the United States is as follows: "I declare [or certify, verify, or state] under penalty of perjury that the foregoing is true and correct. Executed on [*date*]."

However, local practice should be consulted. Some courts may still prefer affidavits to declarations under penalty of perjury. See Moynihan, *Affidavit Evidence*, 14 Litigation 43 (Spring 1988).

See § 5151, Comment.

§ 5155. Allegation of Affidavit Stating Cause of Delay in Filing—Another Form

Defendant says that he did not file this affidavit until this date for the reason that knowledge of such bias and prejudice did not come to him until this date, and the absence of knowledge is good cause for his failure to file the affidavit prior to this date.

COMMENT

See § 5151, Comment; and § 5154, Comment.

§ 5156. Certificate of Counsel Supporting Affidavit

We, the undersigned, _____ and _____, counsel of record in the above-entitled cause, hereby certify that the above affidavit made by _____ is made in good faith.

Dated: _____

_____
Attorney for _____
Address: _____

_____
Attorney for _____
Address: _____

COMMENT

See § 5151, Comment.

§ 5157. Certificate of Counsel Supporting Affidavit—Another Form

I hereby certify that I am counsel of record for _____, defendant [*or* plaintiff] in the above-entitled cause, and that the above affidavit is made in good faith.

Dated: _____

_____
Attorney for _____
Address: _____

COMMENT

See § 5151, Comment.

§ 5158. Certification of Disqualification Upon Filing of Affidavit of Prejudice

[*Title of Court and Cause*]

_____ plaintiff [*or* defendant] in the above-entitled cause has made and filed an affidavit [*or* declaration] that I have a [personal] bias or prejudice against her, and asks that another judge be designated in the cause.

I do hereby, in accordance with the provisions of Section 144 of Title 28 of the United States Code, proceed no further in this motion.

Dated: _____

_____
United States District Judge

COMMENT

See § 5151, Comment.

§ 5159. Order Designating Another Judge

[*Title of Court and Cause*]

Upon the affidavit [*or* declaration] of _____, the certificate of _____, counsel for _____, and certificate of the Honorable _____, District Judge of the _____ District of _____, which have been examined by me;

I, _____, Chief Judge of the _____ Circuit do hereby designate and appoint the Honorable _____, District Judge of the District of _____, to hear and dispose of the above-entitled cause within the _____ District of _____, with all the powers of a judge of the _____ District of _____.

[*Date*]

_____
Chief Judge, _____ Circuit

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 344

Counsel for the respective parties may communicate with Judge _____, who will inform them at what time or times it may be convenient to hold court in the _____ District.

_____
Chief Judge, _____ Circuit

COMMENT

See § 5151, Comment.

§ 5160. Order Designating Another Judge—Another Form

[*Title of Court and Cause*]

The plaintiff _____ has made an affidavit [*or* declaration] of personal bias touching the judge before whom the above-entitled cause is pending, and I hereby designate Honorable _____, District Judge of the _____ District of _____, to try and dispose of the cause.

_____
Chief Judge, _____ Circuit

COMMENT

See § 5151, Comment.

B. INTEREST OR RELATIONSHIP

§ 5161. Order of Judge Disqualifying Oneself Because of Previous Relationship

[*Title of Court and Cause*]

The undersigned Judge, to whom the above-entitled case was assigned pursuant to Local Rule _____, is of the opinion that I should not try this case, by reason of the fact that I was the attorney who incorporated the City of _____ and was its City Attorney from _____ until _____ when I was appointed to the bench. I participated in meetings with the City Manager, City Council and the then Chief of Police with reference to the employment of the defendant _____ as a police officer. The Court hereby orders the case reassigned by the Clerk in accordance with Local Rule _____ or other applicable rule or order of this Court.

IT IS FURTHER ORDERED that the Clerk serve copies of this Order by United States mail on counsel for all parties appearing in this cause.

Dated: _____

_____
United States District Judge

COMMENT

See § 5151, Comment.

§ 5162. Order of Judge Disqualifying Oneself Because of Relationship

[*Title of Court and Cause*]

On [*date*], the plaintiff presented its application for a preliminary injunction. And it appeared that the manager of the plaintiff company is a son of the presiding judge. The judge is of the opinion that it is not proper for the judge to sit in the case and on the judge's own motion declines to hear the application, and orders that the facts with respect to it be entered of record.

Dated: _____

_____
United States District Judge

COMMENT

See § 5151, Comment.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 345

outside the judicial district of this court and is not subject to service of process therein], and the motion having been heard and submitted to the court, and the court being fully advised; therefore,

IT IS ORDERED that this action be and it is dismissed without prejudice, with costs allowed to such defendant.

Dated __4__, 19__5__.

[Signature and title]

NOTES

(See notes in § 1:2321)

§ 1:2323 Order—Directing joinder of indispensable party or, alternatively, dismissal of action [FRCP 12(b)(7), 19(a)]

[Caption, see § 1:2321]

ORDER

On the motion of defendant __1__ *[name]* to dismiss the above-entitled action on the ground that __2__ *[name]* is an indispensable party and has not been joined herein, and the motion having been fully heard and submitted to the court for its decision and it appearing to the court that __3__ *[indispensable party]* is an indispensable party to the award of relief to the present parties of the action, and good cause appearing; therefore,

IT IS ORDERED:

1. That __4__ *[indispensable party]* be joined herein as a party plaintiff, or, if he refuse to be joined as such plaintiff, as __5__ [an involuntary plaintiff *or* a defendant]; and that such joinder shall be effected by plaintiff by appropriate process.

2. That if __6__ *[indispensable party]* cannot be joined as hereinabove directed within __7__ days after the date of this order, this action shall without further order be dismissed by the clerk without prejudice.

Dated __8__, 19__9__.

[Signature and title]

NOTES

(See notes in § 1:2321)

FOIA #57720 (EFTS 16326) ocId: 7010318 Page 346

XI. TRIAL

A. DISQUALIFICATION OF JUDGE OR OTHER JUDICIAL OFFICER; JUDICIAL MISCONDUCT OR DISABILITY

1. INTRODUCTION

§ 1:2331 Scope of division

This division consists of forms and material pertaining to the disqualification of a judge or other judicial officer to preside in a civil action in a United States District Court; and complaints to a Federal Court of Appeals concerning alleged judicial misconduct or disability. Treated elsewhere are forms relating to disclosure as to corporate affiliations, financial interests, and interested parties, which disclosure may be used to determine the need for recusal of a judge,[15] and relief from a judgment.[16]

GENERAL REFERENCES

Federal statutes and court rules that specifically apply to the disqualification of a judge or other judicial officer to preside in a civil action in a United States District Court, or to complaints to a Federal Court of Appeals concerning alleged judicial misconduct or disability, are listed below. **Note:** The General Index to the United States Code Service (USCS) should also be checked.

Statutes:

28 USCS § 144 [disqualification of judge due to personal bias or prejudice].

28 USCS § 372(c) [complaint to Court of Appeals concerning alleged judicial misconduct or disability].

28 USCS § 455 [disqualification of judge, magistrate judge, etc.].

28 USCS § 458 [ineligibility of relative of judge for office or duty in court].

28 USCS § 460 [application of statutes including 28 USCS §§ 455 and 458 to judges of territorial court invested with jurisdiction of District Court].

Court Rules:

Federal Rules of Civil Procedure, Rule 63 [inability of judge to proceed].

Reminder: Always check the advance sheets to the United States Code Service (USCS) for latest court rule changes, and be certain to examine local Court of Appeals and District Court rules in Federal Procedure Rules Service to determine whether any additional or special procedural requirements exist.

RESEARCH REFERENCES

Sources of collateral material related to the disqualification of a judge or other judicial officer to preside in a civil action in a United States District

15. See §§ 1:548-1:552, supra.

16. See §§ 1:3451-1:3480, infra.

Court, or to complaints to a Federal Court of Appeals concerning alleged judicial misconduct or disability, are listed below.

Texts:

7A FED PROC, L ED, Courts and Judicial System §§ 20:17, 20:25, 20:29, 20:41-20:151, 20:193, 20:339-20:363.

33 FED PROC, L ED, Trial §§ 77:183-77:185.

15A AM JUR 2d, Clerks of Court § 9.

16 AM JUR 2d, Constitutional Law § 331.

16A AM JUR 2d, Constitutional Law §§ 855, 856.

27 AM JUR 2d, Equity § 227.

46 AM JUR 2d, Judges §§ 86-236.

Annotations:

ALR INDEX: Attorney or Assistance of Attorney; Bias or Prejudice; Conflict of Interest; Contempt; Due Process; Financial Interest and Benefit; Judges; Magistrates; Prior Acts and Matters; Recusal; Time and Date; Trial by Court.

Trial Aids:

2 AM JUR POF 495, Bias or Prejudice.

20 AM JUR POF 223, Religious Prejudice.

Digests:

L ED DIGEST: Constitutional Law §§ 746, 767, 778.5; Evidence §§ 947, 948; Judges §§ 6-11; Statutes §§ 101.5, 108.4, 164.6; United States § 17.

ALR DIGEST: Constitutional Law §§ 605, 615; Judges §§ 3, 13-25; Reference § 6.

FEDERAL RULES DIGEST: FINDEX 63.1, 63.2.

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§ 1:2332 Annotation references

Annotations which relate to the disqualification of a judge or other judicial officer to preside in a civil action in a trial in a United States District Court, or to complaints to a Federal Court of Appeals concerning alleged judicial misconduct or disability, are listed below.

L Ed annotations:

Contempt proceedings as violating procedural due process—Supreme Court cases. 39 L Ed 2d 1031 [see especially § 5, concerning right to trial before unbiased judge, and disqualification of judge].

Exercise of federal court's summary power to punish for contempt committed in the actual presence of the court. 96 L Ed 762, 3 L Ed 2d 1855 [see especially § 11, concerning disqualification of judge].

ALR Federal annotations:

Disqualification of federal judge, under 28 USCS § 455(b)(5)(ii), on ground that judge's relative is acting as lawyer in proceeding. 73 ALR Fed 879.

Conduct or bias of law clerk or other judicial support personnel as warranting recusal of federal judge or magistrate. 65 ALR Fed 775.

Review of federal judge's grant or denial of motion to recuse. 64 ALR Fed 433.

Mandamus as remedy to compel disqualification of federal judge. 56 ALR Fed 494.

Disqualification of judge under 28 USCS § 455(b)(4), providing for disqualification where judge has financial or other interest in proceeding. 55 ALR Fed 650.

Disqualification of judge under 28 USCS § 455(b)(5)(iii), where judge or his or her spouse, or certain of their relatives, is known to have an interest that could be affected by the proceeding. 54 ALR Fed 855.

Judge's membership in bar association as ground for disqualification under 28 USCS § 455. 42 ALR Fed 331.

Construction and application of 28 USCS § 455(a) providing for disqualification of justice, judge, magistrate, or referee in bankruptcy in any proceeding in which his impartiality might reasonably be questioned. 40 ALR Fed 954.

Timeliness of affidavit of disqualification of trial judge under 28 USCS § 144. 24 ALR Fed 290.

Form and requirements of certificate and affidavit of disqualification of trial judge under 28 USCS § 144. 23 ALR Fed 637.

Disqualification of original trial judge to sit on retrial after reversal or mistrial; federal cases. 22 ALR Fed 709.

Disqualification of federal judge, under 28 USC § 144, for acts and conduct occurring in courtroom during trial or in ruling upon issues or questions involved. 2 ALR Fed 917.

ALR annotations:

Abuse or misuse of contempt power as ground for removal or discipline of judge. 76 ALR4th 982.

Disqualification of judge because of political association or relation to attorney in case. 65 ALR4th 73.

Disqualification of judge because of assault or threat against him by party or person associated with party. 25 ALR4th 923.

Membership in fraternal or social club or order affected by a case as ground for disqualification of judge. 75 ALR3d 1021.

Disqualification of judge, justice of the peace, or similar judicial officer for pecuniary interest in fines, forfeitures, or fees payable by litigants. 72 ALR3d 375.

Affidavit or motion for disqualification of judge as contempt. 70 ALR3d 797.

Power of court to remove or suspend judge. 53 ALR3d 882.

Disqualification of judge because of his or another's holding or owning stock in corporation involved in litigation. 25 ALR3d 1331.

Disqualification of judge for bias against counsel for litigant. 23 ALR3d 1416.

Disqualification of judge on ground of being a witness in the case. 22 ALR3d 1198.

Disqualification of judge for having decided different case against litigant. 21 ALR3d 1369.

Propriety and prejudicial effect of suggestion or comments by judge as to compromise or settlement of civil case. 6 ALR3d 1457 [see especially § 6, generally concerning basis for disqualification of judge or transfer of cause].

Intervenor's right to disqualify judge. 92 ALR2d 1110.

Prohibition as appropriate remedy to prevent allegedly disqualified judge from proceeding with case. 92 ALR2d 306.

Time for asserting disqualification of judge, and waiver of disqualification. 73 ALR2d 1238.

Prior representation or activity as attorney or counsel as disqualifying judge. 72 ALR2d 443.

Disqualification of judge in proceedings to punish contempt against or involving himself or court of which he is a member. 64 ALR2d 600.

Relationship to attorney as disqualifying judge. 50 ALR2d 143.

Mandamus as remedy to compel assertedly disqualified judge to recuse self or to certify his disqualification. 45 ALR2d 937.

FOIA # 57720 (URTS 1632 ocId: 70105318 Page 347

Interest of judge in an official or representative capacity, or relationship of judge to one who is a party in an official or representative capacity, as disqualification. 10 ALR2d 1307.

Reminder: For additional annotation material, consult the ALR Index.

§ 1:2333 Procedural guide

Whenever a party in a proceeding in United States District Court files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias against the party or in favor of an adverse party, the judge must proceed no further in the proceeding, and another judge must be assigned to hear it. An affidavit alleging bias or prejudice on the part of a judge must state the facts and reasons for the belief that such bias or prejudice exists.[17] The affidavit must be filed not less than 10 days before the beginning of the session at which the proceeding is to be heard, unless good cause is shown for failure to file within such time, and it is to be accompanied by a certificate of counsel of record stating that it is made in good faith. A party may file only one such affidavit in any case.[18] In order to be disqualifying, the judge's alleged bias or prejudice must stem from an extrajudicial source and result in an opinion on the merits on some basis other than what the judge learned from participation in the case.[19]

Under certain circumstances, judges and other judicial officers are required to disqualify themselves from a proceeding.[20]

Any person alleging that a circuit, district, bankruptcy, or magistrate judge has engaged in conduct prejudicial to the effective and expeditious

17. Affidavit may be made on information and belief if facts are set forth as basis of belief. Berger v United States (1921) 255 US 22, 65 L Ed 481, 41 S Ct 230 (under predecessor to 28 USCS § 144).

18. 28 USCS § 144.
Texts: 7A Fed Proc, L Ed, COURTS AND JUDICIAL SYSTEM §§ 20:339-20:363.
Annotations: Conduct or bias of law clerk or other judicial support personnel as warranting recusal of federal judge or magistrate. 65 ALR Fed 775.
—Timeliness of affidavit of disqualification of trial judge under 28 USCS § 144. 24 ALR Fed 290.
Form and requirements of certificate and affidavit of disqualification of trial judge under 28 USCS § 144. 23 ALR Fed 637.
Disqualification of federal judge, under 28 USC § 144, for acts and conduct occurring in courtroom during trial or in ruling upon issues or questions involved. 2 ALR Fed 917.
Time for asserting disqualification of judge, and waiver of disqualification. 73 ALR2d 1238.

19. United States v Grinnell Corp. (1966) 384 US 563, 16 L Ed 2d 778, 86 S Ct 1698, 1966 CCH Trade Cases P 71789.

20. 28 USCS § 455.
As to such circumstances, see the checklist in § 1:2334, infra.
Texts: 7A Fed Proc, L Ed, COURTS AND JUDICIAL SYSTEM §§ 20:47-20:151.

administration of the business of the courts, or alleging that such a judge is unable to discharge all the duties of his or her office by reason of mental or physical disability, may file a written complaint with the clerk of the Court of Appeals for the circuit, which complaint must contain a brief statement of the facts constituting such conduct.[21] The chief judge to whom a complaint of judicial misconduct is referred may either (1) dismiss the complaint; (2) conclude that corrective action has already been taken or that action on the complaint is no longer necessary because of intervening events; or (3) appoint an investigative committee to conduct an investigation of the matter and report to the judicial council of the circuit.[22]

If a judge becomes unable to proceed after a trial or hearing has been commenced, any other judge may proceed upon (1) certifying familiarity with the record, and (2) determining that the proceedings in the case may be completed without prejudice to the parties.[23]

A person is ineligible for appointment to or employment in any office or duty in any court where the person is related by affinity or consanguinity within the degree of first cousin to any justice or judge of the court.[24]

§ 1:2334 Checklist—Grounds for disqualification of judge or other judicial officer under 28 USCS § 455[25]

- Reasonable question as to impartiality[26]

21. 28 USCS § 372(c)(1).
Texts: 7A Fed Proc, L Ed, COURTS AND JUDICIAL SYSTEM §§ 20:41-20:46.

22. 28 USCS § 372(c)(3)-(5).

23. FRCP 63.
Texts: 33 Fed Proc, L Ed, TRIAL §§ 77:183-77:185.

24. 28 USCS § 458.
Texts: 7A Fed Proc, L Ed, COURTS AND JUDICIAL SYSTEM § 20:29.

25. For convenience, each pertinent checklist item uses only the term "judge," rather than the full list of judicial officers subject to a provision of § 455—that is, a judge, magistrate judge, and so forth. In addition, this checklist is limited to 28 USCS § 455; see also the other provisions referred to in § 1:2331, supra.

26. 28 USCS § 455(a).
Recusal is required under 28 USCS § 455(a) if a reasonable person, knowing all the circumstances, would expect that the judge would have actual knowledge of facts indicating interest or bias in the case. Liljeberg v Health Services Acquisition Corp. (1988) 486 US 847, 100 L Ed 2d 855, 108 S Ct 2194, 11 FR Serv 3d 433.
It is not a ground for disqualification under 28 USCS § 455 that, prior to nomination, a judge has expressed an understanding of the meaning of a particular provision of the Federal Constitution. Laird v Tatum (1972) 409 US 824, 34 L Ed 2d 50, 93 S Ct 7 (per Rehnquist, J.).

FOIA # 57720 (URTS 16326) Doc Id: 70105318 Page 348

- Personal bias or prejudice concerning a party[27]
- Personal knowledge of disputed evidentiary facts concerning the proceeding[28]
- Associated with action as:
  —Counsel
  —Material witness
  —Associate of counsel who served during such association as representative concerning matter
  —Associate of counsel who has been material witness[29]
- Participated in or expressed an opinion concerning matter while a government employee as:
  —Counsel
  —Adviser
  —Material witness[30]
- Interest which could be substantially affected by outcome of action or financial interest therein or in party thereto, by:
  —Judge as an individual

Annotations: Judge's membership in bar association as ground for disqualification under 28 USCS § 455. 42 ALR Fed 331.
Construction and application of 28 USCS § 455(a) providing for disqualification of justice, judge, magistrate, or referee in bankruptcy in any proceeding in which his impartiality might reasonably be questioned. 40 ALR Fed 954.
Disqualification of judge because of political association or relation to attorney in case. 65 ALR4th 73.
Disqualification of judge because of assault or threat against him by party or person associated with party. 25 ALR4th 923.
Membership in fraternal or social club or order affected by a case as ground for disqualification of judge. 75 ALR3d 1021.
Disqualification of judge, justice of the peace, or similar judicial officer for pecuniary interest in fines, forfeitures, or fees payable by litigants. 72 ALR3d 375.
Disqualification of judge in proceedings to punish contempt against or involving himself or court of which he is a member. 64 ALR2d 600.
Interest of judge in an official or representative capacity, or relationship of judge to one who is a party in an official or representative capacity, as disqualification. 10 ALR2d 1307.

27. 28 USCS § 455(b)(1).
Annotations: Disqualification of judge for bias against counsel for litigant. 23 ALR3d 1416.
Disqualification of judge for having decided different case against litigant. 21 ALR3d 1369.

28. 28 USCS § 455(b)(1).

29. 28 USCS § 455(b)(2).
Annotations: Disqualification of judge on ground of being a witness in the case. 22 ALR3d 1198.
Prior representation or activity as attorney or counsel as disqualifying judge. 72 ALR2d 443.

30. 28 USCS § 455(b)(3).

FOIA # 57720-(URTS 16326) Cld: 70105318 Page 349

—Judge as a fiduciary
—Judge's spouse
—Minor child residing in judge's household[31]

- If judge, judge's spouse, person related within the third degree to either, or the spouse of such person, is:
  —A party or an officer, director, or trustee of a party to the action[32]
  —Acting therein as a lawyer[33]
  —Known by the judge to have an interest which could be substantially affected by the outcome[34]
  —To the judge's knowledge likely to be a material witness in the action[35]
- Exception not requiring disqualification where
  —After substantial judicial time has been devoted to a matter, there is a subsequent appearance or discovery that the judge individually or as a fiduciary, or a spouse or minor child residing in the judge's household, has a financial interest in a party other than an interest that could be substantially affected by the outcome, and
  —The judge, spouse, or minor child divests himself or herself of the interest that provides the grounds for disqualification.[36]

31. 28 USCS § 455(b)(4).
Federal judges are not required by 28 USCS § 455 to disqualify themselves in litigation challenging the constitutionality of federal laws stopping or reducing cost-of-living increases for federal judges. United States v Will (1980) 449 US 200, 66 L Ed 2d 392, 101 S Ct 471.
Annotations: Disqualification of judge under 28 USCS § 455(b)(4), providing for disqualification where judge has financial or other interest in proceeding. 55 ALR Fed 650.
Disqualification of judge because of his or another's holding or owning stock in corporation involved in litigation. 25 ALR3d 1331.

32. 28 USCS § 455(b)(5)(i).

33. 28 USCS § 455(b)(5)(ii).
Annotations: Disqualification of federal judge, under 28 USCS § 455(b)(5)(ii), on ground that judge's relative is acting as lawyer in proceeding. 73 ALR Fed 879.
Relationship to attorney as disqualifying judge. 50 ALR2d 143.

34. 28 USCS § 455(b)(5)(iii).
Annotations: Disqualification of judge under 28 USCS § 455(b)(5)(iii), where judge or his or her spouse, or certain of their relatives, is known to have an interest that could be affected by the proceeding. 54 ALR Fed 855.

35. 28 USCS § 455(b)(5)(iv).

36. 28 USCS § 455(f).

2. PROCEDURAL FORMS

§ 1:2341 Motion and notice—Disqualification of judge—Personal bias or prejudice [28 USCS §§ 144, 455(b)(1)]

UNITED STATES DISTRICT COURT
FOR THE __1__ DISTRICT OF __2__
__3__ DIVISION

__4__
Plaintiff,
v
__6__
Defendant.

Civil Action, File No. __5__
MOTION TO DISMISS

__7__ *[Moving party]* files herewith his [or "her"] affidavit, as required by Title 28, United States Code, Section 144, to show that the Honorable __8__ has a personal bias or prejudice __9__ [against him *or* in favor of __10__].

Based thereon, __11__ *[moving party]* respectfully moves that the Honorable __12__ proceed no further herein and that another judge be assigned to hear this proceeding.

Dated __13__, 19__14__.

[Signature and address]

Notice of Motion

To: __15__, Attorney for __16__ *[opposing party]* __17__ *[address]*

Please take notice that on __18__, 19__19__, at __20__ o'clock __21__m., or as soon thereafter as counsel can be heard, in Room __22__, United States Court House, __23__ *[address]*, the undersigned will bring the above motion on for hearing.

Dated __24__, 19__25__.

[Signature and address]

NOTES

Practice Aids:

Texts: Disqualification for personal bias or prejudice. 7A FED PROC, L ED, Courts and Judicial System §§ 20:94-135.

Annotations: Contempt proceedings as violating procedural due process Supreme Court cases. 39 L Ed 2d 1031 [see especially § 5, concerning right to trial before unbiased judge, and disqualification of judge].

—Conduct or bias of law clerk or other judicial support personnel as warranting recusal of federal judge or magistrate. 65 ALR Fed 775.

—Review of federal judge's grant or denial of motion to recuse. 64 ALR Fed 433.

—Mandamus as remedy to compel disqualification of federal judge. 56 ALR Fed 494.

—Judge's membership in bar association as ground for disqualification under 28 USCS § 455. 42 ALR Fed 331.

—Timeliness of affidavit of disqualification of trial judge under 28 USCS § 144. 24 ALR Fed 290.

—Form and requirements of certificate and affidavit of disqualification of trial judge under 28 USCS § 144. 23 ALR Fed 637.

—Disqualification of original trial judge to sit on retrial after reversal or mistrial; federal cases. 22 ALR Fed 709.

—Disqualification of federal judge, under 28 USC § 144, for acts and conduct occurring in courtroom during trial or in ruling upon issues or questions involved. 2 ALR Fed 917.

—Abuse or misuse of contempt power as ground for removal or discipline of judge. 76 ALR4th 982.

—Disqualification of judge because of political association or relation to attorney in case. 65 ALR4th 73.

—Power of court to remove or suspend judge. 53 ALR3d 882.

—Disqualification of judge for bias against counsel for litigant. 23 ALR3d 1416.

—Disqualification of judge for having decided different case against litigant. 21 ALR3d 1369.

—Time for asserting disqualification of judge, and waiver of disqualification. 73 ALR2d 1238.

—Prior representation or activity as attorney or counsel as disqualifying judge. 72 ALR2d 443.

§ 1:2342 Motion—Disqualification of judge—For interest [28 USCS § 455]

[Caption, see § 1:2341]

__1__ *[Moving party]* shows that the Honorable __2__ is disqualified from presiding as judge at the trial of the above numbered and entitled cause under the provisions of Title 28, United States Code, Section 455, due to __3__ *[set forth cause of disqualification for interest]*, as more fully set forth in the affidavit attached hereto and made a part hereof.

Wherefore, __4__ *[moving party]* moves that the Honorable __5__ declare himself [or "herself"] disqualified to sit on the hearing of this cause and that another judge be assigned to hear this action.

Dated __6__, 19__7__.

[Signature and address]

FOIA # 57720 (URTS 16326) Doc Id: 70105318 Page 350

[Notice of motion, see § 1:2341]

[Attach affidavit]

NOTES

(See also notes in § 1:2341)

Practice Aids:

Texts: Interest of judge or judge's relative in case. 7A FED PROC, L ED, Courts and Judicial System §§ 20:142-20:151.

Annotations: Disqualification of judge under 28 USCS § 455(b)(4), providing for disqualification where judge has financial or other interest in proceeding. 55 ALR Fed 650.

—Disqualification of judge under 28 USCS § 455(b)(5)(iii), where judge or his or her spouse, or certain of their relatives, is known to have an interest that could be affected by the proceeding. 54 ALR Fed 855.

—Disqualification of judge, justice of the peace, or similar judicial officer for pecuniary interest in fines, forfeitures, or fees payable by litigants. 72 ALR3d 375.

—Relationship to attorney as disqualifying judge. 50 ALR2d 143.

—Mandamus as remedy to compel assertedly disqualified judge to recuse self or to certify his disqualification. 45 ALR2d 937.

—Interest of judge in an official or representative capacity, or relationship of judge to one who is a party in an official or representative capacity, as disqualification. 10 ALR2d 1307.

§ 1:2343 Application—Disqualification of judge—For interest—Alternate form [28 USCS § 455]

[Caption, see § 1:2341]

[Title]

To the Honorable Judges of the said Court [or "To the Honorable __1__, Judge of the said court"]:

The petition of __2__, defendant [or "plaintiff"] in the above-entitled cause respectfully represents that the cause of action in the action is for __3__ [or "that the matter in controversy herein is __4__"], and that the Honorable __5__, Judge of said court in which the action was commenced and is now pending, and who is required by law to hear and decide the same, is concerned in interest therein for the reason that __6__ *[state facts which show judge's interest].*

[Or "has been of counsel for __7__ in that action" or "is a material witness for __8__ in that action" or "is related to (or, 'connected with') __9__, plaintiff (or 'defendant') herein in that he (or 'she') is __10__ (state relationship or connection)."]

Wherefore petitioner prays that another judge may be designated in the manner provided by law in such cases.

__11__ Defendant [or "Plaintiff"] and Petitioner [Verification]

NOTES

(See notes in § 1:2342)

FOIA #57720 (FBI TS 16326 ocId: 7010531 Page 351

§ 1:2344 Affidavit—In support of motion to disqualify judge for personal bias or prejudice [28 USCS §§ 144, 455(b)(1)]

[Caption, see § 1:2341]

State of __1__

County of __2__

I, __3__ *[name],* being duly sworn, say:

1. I am the __4__ *[identity of party]* in the above numbered and entitled cause.

2. I am informed and believe, and based on such information and belief, allege that the Honorable __5__, the judge before whom this cause is pending, has a personal bias or prejudice __6__ [against me *or* in favor of __7__ *(identity of any adverse party)].*

3. The facts and the reasons for the belief that such bias or prejudice exists are __8__ *[detail facts].*

Dated __9__, 19__10__.

[Signature]

Sworn to and subscribed before me this __11__ day of __12__, 19__13__.

[Signature and title]

NOTES

(See notes in §§ 1:2341, 1:2342)

§ 1:2345 Affidavit—In support of motion to disqualify judge for personal bias or prejudice—Together with certificate of counsel and application [28 USCS §§ 144, 455(b)(1)]

[Caption, see § 1:2341; venue, see § 1:2344]

__1__, being duly sworn, deposes and says:

1. I am the defendant [or "plaintiff"] in the above-entitled cause.

2. I believe that the Honorable __2__, Judge of the United States District Court in which this action was commenced and is now pending, and before whom it is to be tried or heard, has a personal bias [or "prejudice" or "bias and prejudice"] against me [or "in favor of __3__, the __4__ opposing party herein"], and the reason for such belief is as follows: __5__ *[state facts to show bias or prejudice].*

Dated __6__, 19__7__. (SIG)__8__, Defendant [or "Plaintiff"]

[Jurat, See § 1:2344]

Certificate of Counsel

I hereby certify that I am counsel of record for __9__, defendant [or "plaintiff"] in the above-entitled cause, and as such prepared the above affi-

davit at the request of the defendant [or "plaintiff"], that I am informed as to the proceedings therein, and that such affidavit and application are made in good faith and not for the purpose of hindrance or delay.

__10__, Attorney for __11__

Dated __12__, 19__13__.

To the Clerk of Above-named Court:

Application is hereby made, for the reasons set forth in the foregoing affidavit and certificate, that appropriate proceedings be taken under 28 USC 144 to assign another judge to hear the proceeding.

Dated __14__, 19__15__.

__16__, Attorney for Defendant [or "Plaintiff"]

NOTES

(See notes in § 1:2341)

§ 1:2346 Affidavit—In support of motion to disqualify judge for interest [28 USCS § 455]

[Caption, see § 1:2341; venue, see § 1:2344]

I, __1__, being duly sworn, say:

1. I am the __2__ *[identity of party]* in the above numbered and entitled cause.

2. Judge __3__ has __4__ *[set forth ground of disqualification]* and is therefore disqualified to act in the above numbered and entitled cause under the provisions of Title 28, United States Code, Section 455.

3. The facts showing such interest are __5__ *[set forth facts showing the grounds of disqualification].*

[Signature]

[Jurat, see § 1:2344]

NOTES

(See notes in § 1:2342)

§ 1:2347 Complaint—Alleging judicial misconduct or disability—In Second Circuit (CA2 Rules Appx, Part E) [28 USCS § 372(c)]

JUDICIAL COUNCIL OF THE SECOND CIRCUIT

COMPLAINT AGAINST JUDICIAL OFFICERS UNDER 28 U.S.C. §372(c)

INSTRUCTIONS:

(a) All questions on this form must be answered.

(b) A separate complaint form must be filled out for each judicial officer complained against.

(c) Submit the correct number of copies of this form and the statement of facts. For a complaint against:

a court of appeals judge -- original and 3 copies
a district court judge or magistrate judge -- original and 4 copies
a bankruptcy judge -- original and 5 copies

(For further information see Rule 2(a)).

(d) Service on the judicial officer will be made by the Clerk's Office. (For further information see Rule 3(a)(1)).

(e) Mail this form, the statement of facts and the appropriate number of copies to the Clerk, United States Court of Appeals, United States Courthouse, 40 Foley Square, New York, New York 10007.

1. Complainant's name: _____

Address: _____

_____

Daytime telephone (with area code): [ ]

2. Judge or magistrate judge complained about:

Name: _____

Court: _____

FOIA # 57720 (URTS 1632 ocld: 7010 318 Page 252

Are (were) you a party or lawyer in the lawsuit?

Party [ ] Lawyer [ ] Neither [ ]

If a party, give the name, address, and telephone number of your lawyer:

_____

_____

_____

Docket numbers of any appeals to the __1__ th Circuit:

4. Have you filed any lawsuits against the judge or magistrate?

Yes [ ] No [ ]

If "yes," give the following information about each lawsuit (use the reverse side if there is more than one):

Court:_____

Docket number:_____

Present status of suit:_____

Name, address, and telephone number of your lawyer:_____

_____

Court to which any appeal has been taken:_____

Docket number of the appeal:_____

Present status of appeal:_____

5. On separate sheets of paper, not larger than the paper this form is printed on, describe the conduct or the evidence of disability that is the subject of this complaint. See rule 2(b) and 2(d). Do not use more than 5 pages (5 sides). Most complaints do not require that much.

6. You should either

(1) check the first box below and sign this form in the notary public; or

(2) check the second box and sign the form. You do not need a notary public if you check the second box.

[ ] I swear (affirm that-

[ ] I declare under penalty of perjury that-

(1) I have read rules 1 and 2 of the Rules of the Judicial Council of the 8th Circuit Governing Complaints of Judicial Misconduct or Disability, and

FOIA # 57720 (URTS 16326 ocld: 70105218 Page 353

(2) The statements made in this complaint are true and correct to the best of my knowledge.

_____

(Signature)

Executed on_____

(Date)

Sworn and subscribed to before me_____

(Date)

_____

(Notary Public)

My commission expires:_____

NOTES

(See notes in § 1:2347)

Present status of suit:_____

Your Lawyer's Name:_____

Address:_____

_____

Telephone ( )_____

Court to which any appeal has been taken:_____

Docket number of the appeal:_____

Present status of the appeal:_____

5. On separate sheets of paper, not larger than the paper this form is printed on, describe the conduct or the evidence of disability that is the subject of this complaint. See rule 2(b) and rule 2(d). Do not use more than 5 pages (5 sides). Most complaints do not require that much.

6. You should either

(1) check the first box below and sign this form in the presence of a notary public; or

(2) check the second box and sign the form. You do not need a notary public if you check the second box.

☐ I swear (affirm) that-

☐ I declare under penalty of perjury that-

(1) I have read rules 1 and 2 of the Rules of the Sixth Circuit Governing Complaints of Judicial Misconduct or Disability, and

(2) The statements made in this complaint are true and correct to the best of my knowledge.

_____

(Signature)

Executed on_____

(Date)

Sworn and subscribed
to before me _____
(Date)

_____

(Notary Public)

My commission expires:

NOTES

(See notes in § 1:2347)

FOIA #57720 (URTS 16326 Docld: 70105218 Page 354

§ 1:2351 Complaint—Alleging judicial misconduct or disability—In Eighth Circuit (CA8 Rules, Appx V) [28 USCS § 372(c)]

COMPLAINT FORM

JUDICIAL COUNCIL OF THE 8TH CIRCUIT

COMPLAINT OF JUDICIAL MISCONDUCT OR DISABILITY

MAIL THIS FORM TO THE CLERK, UNITED STATES COURT OF APPEALS, 511 U.S. COURT & CUSTOM HOUSE, 1114 MARKET STREET, ST. LOUIS, MO 63101. MARK THE ENVELOPE "JUDICIAL MISCONDUCT COMPLAINT" OR "JUDICIAL DISABILITY COMPLAINT." DO NOT PUT THE NAME OF THE JUDGE OR MAGISTRATE ON THE ENVELOPE.

SEE RULE 2(ε) FOR THE NUMBER OF COPIES REQUIRED.

1. Complainant's name:

Name_____

Address_____

_____

Daytime telephone: ( )

2. Judge or magistrate complained about:

Name_____

Court_____

_____

_____

_____

3. Does this complaint concern the behavior of the judge or magistrate in particular lawsuit or lawsuits?

Yes [ ] No [ ]

If "yes," give the following information about each lawsuit (use the reverse side if there is more than one):

Court:

Docket number:

X. DISMISSAL

B. INVOLUNTARY DISMISSAL FOR FAILURE TO PROSECUTE OR TO COMPLY WITH COURT RULES OR ORDERS

2. PROCEDURAL FORMS

§ 1:2088 Order—On court's own motion—Dismissal for failu to timely serve—In Western District of Arkans. (Form 9.2) [FRCP 4(m), 41(b)]

Delete section heading in bound volume and substitute the above heading

NOTES

Court Rules: As amended in December 1, 1993, FRCP 4(m) relates to time limit for service of sui mons.

XI. TRIAL

A. DISQUALIFICATION OF JUDGE OR OTHER JUDICIAL OFFICER; JUDICIAL MISCONDUCT OR DISABILITY

INTRODUCTION

§ 1:2333 Procedural guide

Cases:

Even though the "extrajudicial source" doctrine arose under 28 USCS § 144 (and its predecessor)—providing for the disqualification of a federal district judge upon a party's filing of a timely and sufficient affidavit that the judge has a personal bias or prejudice—the extrajudicial source doctrine or factor applies under 28 USCS § 455(a), for (1) § 455(a) requires the disqualification of any justice, judge, or magistrate of the United States in any proceeding in which such a person's impartiality might reasonably be questioned, and 28 USCS § 455(b)(1) requires such a person's disqualification in circumstances where such a person has a personal bias or prejudice concerning a party or personal knowledge of disputed evidentiary facts concerning the proceeding; (2) in view of the pejorative connotation of the words "bias" or "prejudice" as they are used in §§ 144 and 455(b)(1)—as a favorable or unfavorable disposition that is somehow wrongful or inappropriate, because it is undeserved, rests upon knowledge that the subject ought not to possess, or is excessive in degree—the extrajudicial source doctrine is one application of this pejorativeness requirement; and (3) while the "objective appearance" principle of § 455(a) makes irrelevant the subjective limitation of § 455(b)(1)—so that under § 455(a), a judge does not have to be subjectively biased or prejudiced so long as the judge appears to be so—nothing in § 455(a) eliminates the longstanding § 455(b)(1) limitation that personal bias or prejudice does not consist of a disposition that fails to satisfy the extrajudicial source doctrine, where, for example, the objective appearance of an adverse disposition attributable to information acquired in a prior trial is not an objective appearance of personal bias or prejudice and hence not an objective appearance of improper partiality. Liteky v United States (1994, US) 127 L Ed 2d 474, 114 S Ct 1147.

wherein a constituent petition for review is pending. Multiple petitions for review pending in a single circuit shall be allotted only a single entry in the drum. This random selection shall be witnessed by the Clerk of the Panel or a designated deputy other than the random selector. Thereafter, an order on behalf of the Panel shall be issued, signed by the random selector and the witness,

(i) consolidating the petitions for review in the court of appeals for the circuit that was randomly selected; and

(ii) designating that circuit as the one in which the record is to be filed pursuant to Rules 16 and 17 of the Federal Rules of Appellate Procedure.

(b) A consolidation of petitions for review shall be effective when the Panel's consolidation order is filed at the offices of the Panel by the Clerk of the Panel.

Rule 25: Service of Panel Consolidation Order

(a) The Clerk of the Panel shall serve the Panel's consolidation order on the affected agency through the individual or individuals, as identified in Rule 23(c) of these Rules, who submitted the notice of multicircuit petitions for review on behalf of the agency.

(b) That individual or individuals, or anyone else designated by the agency, shall promptly serve the Panel's consolidation order on all other parties in all petitions for review included in the Panel's consolidation order, and shall promptly submit a proof of that service to the Clerk of the Panel. Service and proof of that service shall also be governed by Rule 22 of these Rules.

(c) The Clerk of the Panel shall serve the Panel's consolidation order on the clerks of all circuit courts of appeals that were among the candidates for the Panel's random selection.

THE LIMITED POWER OF THE FEDERAL COURTS OF APPEALS TO ORDER A CASE REASSIGNED TO ANOTHER DISTRICT JUDGE *

by

JACK B. WEINSTEIN **

Some panels of the federal courts of appeals have recently been ordering that a case on remand be heard by a different district court judge than the one who originally decided the case. This kind of order is a matter of concern because it represents an unjustified arrogation of power by some judges of the court of appeals and is destructive of the proper relationship between the trial and intermediate appellate courts.

I have never been subject to such an order. My interest in the subject is as a Chief Judge concerned with the morale of trial judges and with the important joint work of the federal trial and appellate courts. To satisfactorily administer justice, we should have a sense of mutual respect and understanding among all judges as well as a clear delineation of roles.

The assumption of power by an appeals panel to control judge selection can only add to the burdens placed on the trial courts, while adversely and unnecessarily lowering their morale. The district courts have carefully designed plans for the division of business among their judges, and interference from above gums up the works. Trial courts operate every day, often with one judge hearing several motions and supervising more than one jury at a time. If trial judges are to decide properly, they need the power granted them by statute to organize their own assignments.

One justification relied on by appeals panels ordering reassignment is that this is a power seldom used by the courts of appeals. That excuse hardly answers the argument that the power does not exist.

There are, of course, instances in which recusal by a trial judge is desirable. This result can be obtained on motion at nisi prius, ultimately reviewable on appeal, or by mandamus with notice to the trial judge and the right to be heard.

The situation can also be handled informally by the normal give and take of peers advising each other. As chief judge or colleague I have

* These remarks are from an address to the Alexander Fellows of the Benjamin N. Cardozo School of Law, New York City, given on February 22, 1988.

** Chief Judge, United States District Court, Eastern District of New York. While I take full responsibility for the views expressed in this paper, I should like to acknowledge with thanks the help of my present clerk Jonathan Wiener, and my former clerks Marie O'Connell and Anita Bernstein, who assisted with the research.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 356

advised judges to recuse themselves and that advice has always been followed. The chief judge of any Circuit should be aware that his or her views or the views of a panel of the court of appeals can be brought to the attention of the trial judge informally, directly or through the chief judge of the district, when the trial judge may not have seen a difficulty as clearly as the appellate judges. But then the trial judge makes the decision. If he or she refuses to act, our district court Guidelines for the Division of Business among judges provide for involuntary reassignment at the district level. *See* Guidelines for the Division of Business, United States District Court, Eastern District of New York, revised February 17, 1988 [see Appendix].

Only after a motion to recuse is made by a party at trial and denied, or a mandamus proceeding is brought in the court of appeals, does the appellate court have the power to order transfer of a case, on the ground that the trial court abused its discretion in failing to recuse. The original decision whether to recuse is for the district judge. The system for assigning cases to trial judges is for the district court to administer. Congress delegated that power to the district courts under 28 U.S.C. § 137. There are good policy reasons for that delegation.

I. LOCAL GUIDELINES

Our court has recently revised its guidelines for the division of business among our judges to avoid some of the problems involved in assignment on remand and other assignment choices. Guideline 50.2(*l*) of the Guidelines for the Division of Business in the Eastern District of New York provides that the case shall stay with the original judge on remand, except that retrials or resentencing in criminal cases are reassigned at random to another judge. In civil remands and criminal remands not requiring retrial or resentencing, the chief judge or the judge to whom the case is assigned, may decide that another judge ought to be assigned instead.

These guidelines were adopted after careful study and much discussion with the trial bar. They reflect a diligent analysis of the problems confronted by the district court. Guideline 50.2(l) of the Guidelines for the Division of Business in the Eastern District of New York now reads as follows:

(l) Appeals—Assignment on Reversal or Remand

(1) In a criminal case upon reversal of a judgment and a direction for retrial or resentence, on receipt of the mandate of the appellate court the clerk shall randomly select a different judge to preside over the case. Notwithstanding this provision the chief judge may order the case assigned to the original presiding judge to avoid placing an excessive burden on another judge.

(2) In a civil case upon reversal the case shall remain assigned to the judge who was previously assigned, unless the chief judge or his designee orders otherwise.

Revised February 17, 1988. [See Appendix p. 286.]

In accordance with present practice, the judge assigned may recuse himself or herself or ask that the chief judge of the district court, or his

or her designee, assign the case to another judge. The chief judge may take the initiative to reassign. It is essential that the rule permit the chief judge discretion to avoid such problems as overloading judges and to give temporary relief to a trial judge conducting an extended trial. Reassignment will be made pursuant to a random selection procedure outlined in Guideline 50.2(b).

The guideline is neither predicated upon power granted by, nor inconsistent with, the Federal Rules of Civil or Criminal Procedure. *Cf.* Fed.R.Crim.P. 57; Fed.R.Civ.P. 83; N.D.Ill.R. 44; S.D.Ind.R. A–8; D.Mass.R. 8(h); D.R.I.R. 7(g); Seventh Circuit Court R. 18. It is adopted pursuant to 28 U.S.C. § 137, set out *infra*.

Generally, the practice in this district has been for a resentencing on remand to be by the same judge who originally sentenced the defendant. Having the judge who is most familiar with the defendant's case (and who in many cases has heard trial testimony) resentence the defendant is usually both the most efficient use of judicial resources and fair for the defendant and the government. Some concern about disparity in sentencing is alleviated in the United States District Court for the Eastern District of New York because of the practice of having a three-judge panel discuss sentencing recommendations and because of regular and extensive consultation with the Probation Department. This practice has worked well for a number of years.

Nevertheless, after consultation with the bar, the judges decided to experiment with a resentencing change that will normally send the case to a new judge after a remand for resentencing. This new practice will avoid the embarrassment of having some panels of the court of appeals require such transfers on a haphazard basis. Moreover, under the new mandatory sentencing guidelines many factual inquiries may need to be made, requiring, in effect, an extended hearing when resentencing is ordered. The defendant suffers no added risk when the resentencing is before a new judge, because, absent unusual circumstances, the sentence on remand may be no greater than the original sentence, in order to avoid chilling the exercise of the right to appeal. *See Blackledge v. Perry*, 417 U.S. 21, 28, 94 S.Ct. 2098, 2102, 40 L.Ed.2d 628 (1974); *North Carolina v. Pearce*, 395 U.S. 711, 725–26, 89 S.Ct. 2072, 2080–81, 23 L.Ed.2d 656 (1969); *United States v. Whitley*, 734 F.2d 994, 996–97 (4th Cir.1984).

II. STATUTORY SCHEME

In considering the power to assign we turn first to the statutory scheme. Section 137 of Title 28 places in the district court, and particularly the Chief Judge of the district, responsibility for division of business among the district judges. It reads:

§ 137. Division of business among district judges

The business of a court having more than one judge shall be divided among the judges as provided by the rules and orders of the court.

The chief judge of the district court shall be responsible for the observance of such rules and orders, and shall divide the business and

FOIA # 57720 (URTS 16[illegible]6) DocId: 70105318 Page 357

assign the cases so far as such rules and orders do not otherwise prescribe.

If the district judges in any district are unable to agree upon the adoption of rules or orders for that purpose the judicial council of the circuit shall make the necessary orders.

Judicial councils of the Circuit—not panels of appellate judges—have some administrative supervisory powers. *See* 28 U.S.C. § 332. But as the revisor's notes to section 137 point out, section 332 does not limit the district court's powers under section 137. The notes to section 137 read:

Section was rewritten and the practice simplified. It provided for division of business and assignment of cases by agreement of judges ...

The revised section [137] is consistent with section 332 of this title, the last paragraph of which requires the judicial council to make all necessary orders for the effective and expeditious administration of the business of the courts within the circuit.

See Federal Civil Judicial Procedure and Rules 469 (West 1987).

Judicial councils are constituted so as to include both court of appeals and district judges. *See* 28 U.S.C. § 332(a)(1). It is the council, not individual appellate panels, that may "make all necessary and appropriate orders for the effective and expeditious administration of justice within its circuit." 28 U.S.C. § 332(d)(1). *See generally* 16 Wright, Miller, Cooper & Gressman, *Federal Practice and Procedure* § 3939 & n. 27 (1977 & Supp.1987). This supervisory authority extends to both the courts of appeals and district courts. 28 U.S.C. § 332. The judicial council may "abrogate" local rules adopted pursuant to the Federal Rules of Procedure. Fed.R.Civ.P. 83; 16 Wright, Miller, Cooper & Gressman, *Federal Practice and Procedure* § 3939 n. 27 (Supp.1987). This power of abrogation under Rule 83 does not extend to guidelines for the division of business adopted pursuant to section 137 of Title 28.

The general power of appellate courts to "require further proceedings ... as may be just" does not encompass the division of business. That appellate power is contained in 28 U.S.C. § 2106, reading:

§ 2106. Determination

The Supreme Court or any other court of appellate jurisdiction may affirm, modify, vacate, set aside or reverse any judgment, decree, or order of a court lawfully brought before it for review, and may remand the cause and direct the entry of such appropriate judgment, decree, or order, or require such further proceedings to be had as may be just under the circumstances.

Appropriate proceedings may be ordered, but the statute does not authorize the appellate court to say what judge in a multijudge court shall preside—that issue is covered by section 137.

Where the court of appeals has some power over administrative matters concerning the district courts, the authority is granted by specific statute. *See, e.g.,* 28 U.S.C. § 152 (court of appeals appoints bankruptcy judges after consideration of recommendations of judicial council); *cf.* 18 U.S.C. § 3165 (judicial council approval of district court

speedy trial plans); 28 U.S.C. § 1863 (approval of plans for random jury selection); and 28 U.S.C. § 753 (approval of court reporter management plans).

This statutory scheme is better understood in light of the history of the relationship between the federal district and appellate courts. It is to this history that I now turn.

III. HISTORICAL BACKGROUND

Control over the conduct of individual judges has been a subject of interest since at least as early as Roman times. The *Leges Visigothorum,* a code of law used in the Roman empire during the seventh century, noted what constituted judicial misconduct: for example, the refusal to hear a case, prejudicial delay, the rendering of a decision contrary to received law, and receiving bribes. Roman law had a quasi-tort cause of action called the *actio in indicem qui litem suam facit,* permitting a litigant to sue a judge for false judgment. This action was seldom if ever used. It appears that the action would have been brought before a royal court. As a procedural safeguard, the accused judge could escape liability through oath taking, and the aggrieved litigant had to produce witnesses. *See generally* Hoeflich, *Regulation of Judicial Misconduct from Late Antiquity to the Early Middle Ages,* 2 Law & Hist. Rev. 79 (1984).

Under English common law, some judges held office during good behavior by patent of the King, and were subject to the control of the King's Bench, a court independent of the monarch from at least the sixteenth century on. Raoul Berger writes:

By virtue of its 'general Superintendency over all inferior Courts,' King's Bench would punish judges of lesser courts by Attachment for Contempt 'for acting unjustly, oppressively, or irregularly,' 'for any practice contrary to the plain rules of natural Justice ... as for denying a Defendant a Copy of the Declaration against him ... or for compelling a Defendant to give exorbitant bail' and 'putting the Subject to unnecessary Vexation by colour of a judicial Proceeding wholly unwarranted by Law.' ... '[T]he Court of King's Bench, by the Plenitude of its Power, exercises a Superintendency over all inferior Courts, and may grant an Attachment against the Judges of such Courts for oppressive, unjust or irregular Practice, contrary to the obvious Rules of Natural Justice.'

Berger, *Impeachment of Judges and "Good Behavior" Tenure,* 79 Yale L.J. 1475, 1503 n. 142 (1970) (first two ellipses in original) (citations omitted). In addition, it appears that the King's Bench could use its writ of *scire facias* (a proceeding to declare a forfeiture of the patent, comparable to an order to show cause to repeal a judicial commission) to discipline judges. *See id.* at 1479–81; *see also* Ervin, *Separation of Powers: Judicial Independence,* 35 Law & Contemp.Probs. 108, 110–11 (1970); Biancala, *For Want of Justice: Legal Reforms of Henry II,* 88 Colum.L.Rev. 433 (1988). Judge Irving Kaufman has maintained that *scire facias* was only used against administrative officials with life tenure, never against judges. *See* I. Kaufman, *Chilling Judicial Inde-*

FOIA # 97720 (URTS 1635) DocId: 7010538 Page 358

pendence 20–29 (1979). Berger cites in support of his argument the experience of Sir John Walter, whom Charles I asked to surrender his patent in 1628; Walter refused to do so, saying that he was entitled to a *scire facias* proceeding by judges: "Thus a highly placed judge affirmed that his office could be forfeited for misbehavior in a *scire facias* proceeding." Berger, *supra* at 1481. Yet there appears to be no recorded history of a judge removed by judges through *scire facias*. Schoenbaum, *A Historical Look at Judicial Discipline*, 54 Chi.-Kent L.Rev. 1, 14 (1977). *See generally* Shartel, *Federal Judges—Appointment, Supervision & Removal—Some Possibilities Under the Constitution*, 28 Mich.L.Rev. 485, 723, 870 (Parts 1–3) (1930) (suggesting supervision of district judges by Chief Justice and presiding circuit judges).

In framing the United States Constitution, the members of the Constitutional Convention provided judges with tenure "during good behavior" to ensure their independence from the legislature and the executive. United States Constitution, Art. III, § 1. The drafters of the Constitution rejected many traditional controls over judges, deliberately making no provision for executive removal of the judiciary or for legislative removal by bills of attainder (legislative declaration of a person's guilt), bills of pains and penalties (declarations of guilt where the punishment was less than death), and address (legislative removal for offenses that were less than impeachable). *See* Cameron, *The Inherent Power of a State's Highest Court to Discipline the Judiciary*, 54 Chi.-Kent L.Rev. 45, 49 (1977). Debate on a motion made on the floor of the Convention to provide for removal by the President on application of the Senate and House of Representatives (a form of joint address) reveals the framers' intent not to subject judges to extrabranch control except by impeachment. Gouveneur Morris called removal by address a "contradiction in terms" since it would subject judges serving during good behavior to removal without a trial; Edmund J. Randolph "opposed the motion as weakening too much the independence of the Judges." II M. Farrand, *The Records of the Federal Convention of 1787* 428–29 (rev. ed. 1966). Removal by address was explicitly rejected by the framers, the motion being defeated by a vote of seven to one, with three states absent. *See id.* at 429. Removal upon "impeachment for, and conviction of, treason, bribery, or other high crimes and misdemeanors," of course, remained. United States Constitution, Art. II, § 4; *see id.*, Art. III, § 1.

I shall refrain from discussing the present plan for disciplining federal judges (which I consider in large part unconstitutional) because it is irrelevant to the present discussion. Responsibility for discipline is placed in the circuit judicial councils and in the United States Judicial Conference, not in the courts of appeals. *See* 28 U.S.C. § 372(c).

These constitutional choices made by the founding fathers show support for the concept of an independent judiciary in the United States, but they are inconclusive on the nature of that independence. Is an independent judge independent from his fellow judges or only from encroachment by the legislature and executive? Assertions in both directions exist. Because the boundaries of judicial independence have seldom needed clear delineation, the debate has been largely a rhetorical one

See e.g., Rehnquist, *Political Battles for Judicial Independence*, 50 Wash.L.Rev. 835, 842 (1975) ("the unwritten constitutional law surrounding Article III" supports judicial independence "even at the cost of enduring partisan judges"); Ervin, *Separation of Powers: Judicial Independence*, 35 Law & Contemp.Probs. 108, 121 (1970) ("judicial independence was ... a *sine qua non*" to the framers, who intended "that each individual judge would be free from coercion even from his own brethren."); Ziskind, *Judicial Tenure in the American Constitution: English and American Precedents*, 1969 Sup.Ct.Rev. 135, 153 (1969) (framers' "purpose was to create a truly independent judiciary limited only by the cumbersome process of impeachment"); Otis, *A Proposed Tribunal: Is It Constitutional?*, 7 U.Kan.Cty.L.Rev. 3 (1938) (impeachment the sole method of control); Note, *In Defense of the Constitution's Judicial Impeachment Standard*, 86 Mich.L.Rev. 420 (1987) (framers intended that impeachment be sole method, though cumbersome, in order to safeguard judicial independence); Note, *Unnecessary and Improper: The Judicial Councils Reform and Judicial Conduct and Disability Act of 1980*, 94 Yale L.J. 1117, 1125 nn. 52 & 53 (1985) (collecting sources; author favors absolute independence); *but see* Berger, *Impeachment of Judges and "Good Behavior" Tenure*, 79 Yale L.J. 1475, 1476–77 (1970) (Art. II, § 4's provision of impeachment for conviction of "high crimes and misdemeanors" is narrower than Art. III, § 1's provision of judicial tenure during "good behavior"; therefore Congress may provide for other methods of removing judges whose misbehavior is not impeachable); Shartel, *Federal Judges—Appointment, Supervision, and Removal—Some Possibilities under the Constitution*, 28 Mich.L.Rev. 870 (1930) (arguing that jurisdiction to discipline judges is not inconsistent with the Constitution).

Although this constitutional debate has not been resolved, the early American common law preserved a version of traditional King's Bench mandamus, an encroachment of judges upon judges. Chief Justice Marshall, the leading American proponent of judicial review, had a strong sense of hierarchy within the judiciary. To Marshall, the superior court must lead the inferior to do what it "determine[s], or at least supposes, to be consonant to right and justice." *Ex Parte Crane*, 30 U.S. (5 Pet.) 190, 192, 8 L.Ed. 92 (1830). *Crane* shows none of the hesitancy that arose in later case law, when mandamus began to be thought of as an "extraordinary remedy," a response to "usurpation." Marshall's language differs little from that of Blackstone:

> [I]t is the peculiar business of the court of king's bench to superintend all other inferior tribunals, and therein to enforce the due exercise of those judicial or ministerial powers with which the crown or legislature have invested them; and this, not only by restraining their excesses, but also by quickening their negligence and obviating their denial of justice.

3 W. Blackstone, Commentaries 110, *cited in Ex Parte Crane*, 30 U.S. at 192.

Much of this constitutional and English history is not helpful in resolving the issue before us because the courts of appeals are a relatively late addition to our federal court structure. They were created

FOIA # 97720 (URTS 16[illegible]6) DocId: 70105318 Page 399

by statute and granted limited statutory powers. Even the Supreme Court, which could justly claim to have received all the judicial power of both the King's Bench and Parliament, has been from the outset prudently modest in claiming the inherent power of procedural superintendence over other federal courts. *See, e.g.*, The Federalist No. 81 (A. Hamilton) (distinguishing Supreme Court's judicial power under American system from Parliament's power under British system); J. Goebbel, Jr., I History of the Supreme Court of the United States: Antecedents and Beginnings to 1801, 784–93 (1971) (discussing powers of superintendence); J. Weinstein, Reform of Court Rule–Making Procedures 59, 65–75 (1977) (Supreme Court's rulemaking power exercised pursuant to statutes).

IV. MODERN JUDICIAL SUPERVISION: THE RISE OF COMITY BETWEEN COURTS

A. *Creation of the Court of Appeals*

Hierarchy in the lower federal courts as we know it is a relatively recent phenomenon. The Judiciary Act of 1789 created two sets of trial courts of original jurisdiction, not a two tiered court system under the Supreme Court. Both district and circuit courts were originally trial courts with extremely limited jurisdiction when compared with the modern district courts. Originally the district courts were specialty courts, hearing admiralty and certain minor civil and criminal cases. Thirteen districts were established, coterminous with the new states, and permanent resident judges were appointed. The three circuit courts exercised original jurisdiction in cases resting on diversity of citizenship. The circuit courts were staffed by Supreme Court justices "riding circuit" sitting with district judges of that circuit.

Additionally, the circuit courts had a limited appellate jurisdiction over district court decisions in admiralty and civil cases. Professors Frankfurter and Landis, in their classic study of the federal judicial system, concluded that

> [t]he volume of th[e] [circuit courts'] appellate business with their original jurisdiction [while] not disclosed by available data.... could not have been very considerable if later figures are a dependable guide to the earlier period. The district and circuit courts were in practice two *nisi prius* courts dealing with different items of litigation.

F. Frankfurter and J. Landis, *The Business of the Supreme Court* 12–13 & nn. 35–36 (1928). Because federal jurisdiction was so narrow, these courts were able to manage their small caseloads with little centralization.

The expansion of federal court jurisdiction during the nineteenth century strained this court system and led to the authorization of general federal question jurisdiction in 1875. *See* Act of March 3, 1875, 18 Stat. 470. In 1891, Congress created a court system at the intermediate appellate level to alleviate the burdens on the Supreme Court. *See* Circuit Court of Appeals Act, Mar. 3, 1891, ch. 517, 26 Stat. 826.

Congress has followed the constitutional scheme of federal jurisdiction, which accords the Supreme Court constitutional status, with inferior courts to be created by Congress as needed. Both district and intermediate appellate courts are similar statutory creations. The federal court system does not preserve, in this relationship, the hierarchical authority of royal or superior courts over courts with more limited charters. In the system of seventeenth century England, lower courts were satellites, regional offices of a superior court. In the United States, the courts of appeals were established after many working years without them; no denigration of the general administrative power of the district courts to control themselves was accomplished by creation of the intermediate federal appellate system.

The need for intermediate appellate review in the federal courts was clear in 1891. With circuit and district courts both maintaining original jurisdiction, the limited right of appeal in most cases led only to the Supreme Court. The legislative history of the Circuit Court of Appeals Act asserted that the proposed bill "destroys the 'judicial despotism' of the present system by creating an intermediate appellate court...." H.R.Rep. No. 942, 50th Cong., 1st Sess. at 4 (1888). An intermediate court "simplifies the whole judicial establishment by modelling the system largely after the systems in the [state courts]." *Id.* Another goal of the legislation was to "relieve the Supreme Court of very considerable unimportant litigation." *Id.* at 3.

The structure of the Circuit Court of Appeals Act shows that it was designed to create appellate courts of limited jurisdiction apart from the dual trial court system, thus rearranging the jurisdiction of the lower courts. The bill first divested the existing circuit courts of their appellate jurisdiction. Ch. 517, § 4, 26 Stat. 826, 827. Later it gave the new circuit courts of appeals the power to review final judgments and certain interlocutory orders of the district courts. *See* ch. 517, § 6, 26 Stat. 826, 828, codified at 28 U.S.C. §§ 1291, 1292. The original jurisdiction of the circuit courts remained until its abolition in 1911, which ended the system of two sets of federal trial courts. *See* Act of Mar. 3, 1911, 36 Stat. 1087.

The Circuit Court of Appeals Act preserved the power of the federal courts to issue writs in aid of their jurisdiction. Ch. 517, § 12, 26 Stat. 826, 829. The All Writs Act authorizes the modern use of mandamus and prohibition by the courts of appeals. *See* 28 U.S.C. § 1651. Proper use of this power requires an accurate sense of the boundaries of that jurisdiction: to review errors of law.

Limited authority to control assignment of cases, administrative control of judges, or control over judicial conflict outside the boundaries of the rule of law in a particular case, exists only 1) in the district court sitting as a body, 2) to a limited degree in the judicial council of the circuit as provided by specific statute, 3) to a limited degree in the court of appeals as a body as provided by specific statute, 4) in the Judicial Conference of the United States as provided by statute, and 5) possibly in the Supreme Court as successor to the Court of Kings Bench. It does not exist in an appellate panel which is reviewing a specific case only for specific errors of law in the particular case by a particular federal judge.

FOIA # 57720 (URTS 16[illegible]) DocId: 70105318 Page 360

B. *The Scope of Mandamus*

Case law since the creation of the courts of appeals has recognized the evolution of the federal court system from the Blackstone–Marshall hierarchy to a structure with more evenly allocated powers. Mandamus is now an extraordinary writ available to "all courts established by Act of Congress." *See* All Writs Act, 28 U.S.C. § 1651 (authority to grant writs only when "necessary or appropriate"). A judge may be controlled by another judge, or panel, only under extraordinary and constrained conditions. In contrast, a judgment, a matter of law, is subject to an appellate court's decision to "affirm, modify, vacate, set aside or reverse." *See* 28 U.S.C. § 2106.

Will v. United States, 389 U.S. 90, 88 S.Ct. 269, 19 L.Ed.2d 305 (1967), illustrates this evolved view of mandamus. In *Will* the district court had, apparently intentionally, disregarded discovery rules for a criminal case. *See* 389 U.S. at 100–01, 88 S.Ct. at 276. Nevertheless, the Supreme Court disapproved of the court of appeals' summary issuance of mandamus because the practice was isolated, not a persistent problem; the apparent lapse of the district judge was insufficiently extraordinary. The Court emphasized that mandamus is limited to situations where a judge has intentionally exceeded, or refused to exercise, the authority within his discretion. *See* 389 U.S. 102–05, 88 S.Ct. at 277–79 (rejecting mandamus where judge has not pursued "a deliberate policy in open defiance of the federal rules").

Will came after what had been the major precedent on mandamus, *La Buy v. Howes Leather Co.*, 352 U.S. 249, 77 S.Ct. 309, 1 L.Ed.2d 290 (1957). There the Supreme Court approved of mandamus against a district judge whose *practice* it had been to refer antitrust cases to a master, in derogation of Federal Rule of Civil Procedure 53(b), which provides that in nonjury cases some "exceptional condition" must require the reference. Issuance of the writ was justified where the orders of reference "amounted to little less than an abdication of the judicial function depriving the parties of a trial before the court on the basic issues involved in the litigation." 352 U.S. at 256, 77 S.Ct. at 313. The Court declared that appellate courts have general supervisory powers to facilitate judicial administration. *See* 352 U.S. at 259–60, 77 S.Ct. at 315; *see also Schlagenhauf v. Holder*, 379 U.S. 104, 110–12, 85 S.Ct. 234, 238–39, 13 L.Ed.2d 152 (1964) (court of appeals should have decided all issues raised on mandamus concerning novel question of district court's power under Federal Rule of Civil Procedure 35 to order examinations of a defendant).

Will explicitly distinguished *La Buy*, limiting it to deliberate and persistent breaches of procedure. *See Will v. United States*, 389 U.S. at 102–05, 88 S.Ct. at 277–79. The four dissenters in *La Buy* maintained that the majority erroneously read the All Writs Act as conferring on appellate courts a source of independent appellate power; the *Will* court suggested that there was no such power. *See La Buy v. Howes Leather Co.*, 352 U.S. at 263, 77 S.Ct. at 317 (Brennan, J., dissenting); *Will v. United States*, 389 U.S. at 98, 88 S.Ct. at 275. It could therefore be argued that *Will* has overruled the assertion in *La Buy* "that supervisory control of the District Courts by the Courts of Appeals is necessary to prop-

er judicial administration in the federal system." 352 U.S. at 259–60, 77 S.Ct. at 315. In a later case, then-Justice Rehnquist, writing for the Court, stated that although the respondent had probably satisfied the standard for review on appeal, it could not meet its burden of showing a "clear and indisputable" right to issuance of the writ of mandamus because the inaction complained of was within the district court's discretion. *See Will v. Calvert Fire Insurance Co.*, 437 U.S. 655, 665–66 & n. 7, 98 S.Ct. 2552, 2558–59 & n. 7, 57 L.Ed.2d 504 (1978).

Courts of appeals have, nevertheless, tended in recent years to use mandamus more freely than Supreme Court precedents have approved, with no interference from the Supreme Court and little objection from academic commentators. *See e.g.*, Fullerton, *Exploring the Far Reaches of Mandamus*, 49 Brooklyn L.Rev. 1131 (1983); Ward, *Can the Federal Courts Keep Order in Their Own House?* 1980 Brigham Young L.Rev. 233; Note, *Supervisory and Advisory Mandamus Under the All Writs Act*, 86 Harv.L.Rev. 595, 598 (1973) (finding endorsement of limited use of "advisory" mandamus in *La Buy's* "supervisory" mandamus). Supervisory mandamus has been used in a variety of circumstances. *See, e.g., In re Virginia Electric & Power Co.*, 539 F.2d 357 (4th Cir.1976) (mandamus to offer guidance to district judges on when *not* to recuse under 28 U.S.C. § 455); *Sanders v. Russell*, 401 F.2d 241 (5th Cir.1968) (writ issued to void local rule on *pro hac vice* appearances); *Rapp v. Van Dusen*, 350 F.2d 806 (3d Cir.1965) (disqualifying district judge). As will be pointed out below, there is little warrant for much of this action by appellate panels given the explicit power of the district courts, Circuit Councils and United States Judicial Conference to supervise.

C. *Orders of Reassignment on Appeal*

While mandamus may lie to correct error in a case of disqualification, the power asserted by some panels of court of appeals judges to reverse a district court decision with an order that the case be assigned to another district judge is without statutory basis. For examples of such assertions of inherent power on appeal, *see, e.g., Sobel v. Yeshiva University*, 839 F.2d 18 (2d Cir.1988); *Outley v. City of New York*, 837 F.2d 587 (2d Cir.1988); *United States v. Pugliese*, 805 F.2d 1117 (2d Cir.1986); *United States v. Sears, Roebuck & Co.*, 785 F.2d 777 (9th Cir.), *mandamus denied sub nom. In re Real*, 479 U.S. 982, 107 S.Ct. 604, 93 L.Ed.2d 604 (1986); *United States v. Ritter*, 273 F.2d 30 (10th Cir.1959), *cert. denied*, 362 U.S. 950, 80 S.Ct. 863, 4 L.Ed.2d 869 (1960).

Most recently, the Second Circuit issued four such orders to reassign for sentencing. *See United States v. Stratton*, 820 F.2d 562 (2d Cir. 1987); *United States v. Louis*, 814 F.2d 852 (2d Cir.1987); *United States v. Pugliese*, 805 F.2d 1117 (2d Cir.1986); *United States v. Diaz*, 797 F.2d 99 (2d Cir.1986). Other precedents exist in that circuit. *See United States v. Robin*, 545 F.2d 775 (2d Cir.1976), *reh'g denied*, 553 F.2d 8 (2d Cir.1977) (en banc); *United States v. Rosner*, 485 F.2d 1213, 1231 (2d Cir.1973), *cert. denied*, 417 U.S. 950, 94 S.Ct. 3080, 41 L.Ed.2d 672 (1974); *United States v. Brown*, 470 F.2d 285, 288–89 (2d Cir.1972).

Earlier cases seem to have recognized the lack of power to order reassignment, since circuit panels confined their remarks on reassignment

FOIA # 57720 (URTS 16[illegible]6) DocId: 70105318 Page 361

to "recommendations" to the district court on how it should exercise its statutory authority to divide its business. *See* 28 U.S.C. § 137; *United States v. Clark*, 475 F.2d 240, 251 (2d Cir.1973) ("a hearing before another member of the court is advisable"); *United States v. Brown*, 470 F.2d 285, 288–89 (2d Cir.1972) ("we think it best that further proceedings be assigned to a different judge"); *United States v. Bryan*, 393 F.2d 90, 91 (2d Cir.1968) (assumes trial judge "will act pursuant to our views regarding the preferred practice" of a new trial before another judge); *United States v. Mitchell*, 354 F.2d 767, 769 (2d Cir.1966) (chief judge, "in the interest of sound judicial administration, would be wise to re-assign the case to another judge for re-trial").

United States v. Yagid, 528 F.2d 962 (2d Cir.1976), demonstrates the dangers that can arise from the interference with normal case assignments at the trial level by an appellate panel. Yagid, one of three defendants jointly tried and convicted, appealed and obtained an order for a new trial because of Jencks Act violations by the prosecution. *See United States v. Badalamente, et al.*, 507 F.2d 12 (2d Cir.1974), *cert. denied*, 421 U.S. 911, 95 S.Ct. 1565, 43 L.Ed.2d 776 (1975). The appellate panel, in the course of its opinion declining to rule on Yagid's other claim, stated:

> Because it is possible that at the new trial the district judge who presided at the original trial may be required to testify concerning certain aspects of the suppression, we will not consider Yagid's other claims of reversible error. This is so because on retrial, another district judge *should* preside and he will not be bound by the rulings of the original trial judge ...

507 F.2d at 15 (emphasis added). On remand, the indictment had to be dismissed without prejudice for failure to retry the defendant within 90 days of his successful appeal. This failure occurred at least in part because of confusion in the district court over how the reassignment of the case should proceed. *See United States v. Yagid*, 528 F.2d at 963–65. The appellate panel's response was to chide the district court for not reading "should" as "must": "Such suggestions contained in appellate opinions should not be deemed merely precatory because they are not 'ordered,' especially when a retrial is mandated." 528 F.2d at 965 (footnote omitted). In support of this reading the panel cited, *inter alia*, a case from the previous year in which an appellate panel found it "advisable" that a new suppression hearing be held before another judge although it gave no opinion as to who should preside at the retrial. *See Yagid*, 528 F.2d at 965 n. 5; *United States v. Clark*, 475 F.2d 240, 251 (2d Cir.1973).

Courts more recently have used 28 U.S.C. § 2106, a catchall grant of authority to issue orders in aid of jurisdiction, to make reassignment an element of the mandate. This power can be explained and justified in a more principled fashion than the courts have used: Reassignment should be a device of the appellate court that meshes with the district judge's duty of recusal. Self-recusal is impractical in the event of systemic and deliberate repeated errors of law. There the court of appeals need not await action by the district judge, but may proceed by extraordinary writ of mandamus, after notice is given to the district judge. Reassignment

to avoid bias, however, is a question that statutorily falls first on the district judge.

D. *Statutes Dealing With Recusal in Individual Cases*

Both sections 144 and 455 of Title 28, dealing with disqualification, are obviously designed to permit a district judge to pass upon the matter, before his or her decision is reviewed on appeal. Section 144 reads:

> § 144. Bias or prejudice of judge
>
> Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding.
>
> The affidavit shall state the facts and the reasons for the belief that bias or prejudice exists, and shall be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, or good cause shall be shown for failure to file it within such time. A party may file only one such affidavit in any case. It shall be accompanied by a certificate of counsel of record stating that it is made in good faith.

And section 455 reads in part:

> § 455. Disqualification of justice, judge, or magistrate
>
> (a) Any justice, judge, or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.

It appears to be a violation of these statutory provisions for the court of appeals to reassign for bias if the district judge has not first passed on the matter. *See, e.g. United States v. Haldeman*, 559 F.2d 31, 131 & n. 287 (D.C.Cir.1976) ("involved judge has the prerogative, if indeed not the duty," to decide bias question), *cert. denied*, 431 U.S. 933, 97 S.Ct. 2641, 53 L.Ed.2d 250 (1977); *Berger v. United States*, 255 U.S. 22, 36, 41 S.Ct. 230, 234, 65 L.Ed. 481 (1921) (challenged judge "had a lawful right to pass upon the sufficiency of the affidavit" of bias). *Cf.* Stempel, *Rehnquist, Recusal and Reform*, 53 Brooklyn L.Rev. 589, 632–39 (1987).

Where disciplinary action against a judge is required, the judicial council may have power to act under 28 U.S.C. § 372(c) (assuming that this provision is constitutional). The judicial council of the various circuits are subject to detailed rules controlling the exercise of this power. Rule 0.24 of the Second Circuit provided from the outset, for example, that adoption of these disciplinary rules "shall not be construed as indicating any views with respect to the constitutionality of Title 28 U.S.C. § 372(c) or of any action taken thereunder." 16 Wright, Miller & Cooper, *Federal Practice and Procedure* § 3939, Supp. at 237 (Supp. 1987). *See also* Note, *Unnecessary and Improper: The Judicial Councils Reform and Judicial Conduct and Disability Act of 1980*, 94 Yale L.J. 1117, 1124–25 (1985) (questioning authority of judicial council to control district judges); Ervin, *Separation of Powers: Judicial Independence*, 35 Law & Contemp. Probs. 108 (1970) (discussing original bill).

FOIA # 57720 (URTS 1632) DocId: 70103318 Page 362

E. *Extraordinary Writ Jurisdiction to Remedy Repeated Errors of Law*

The appellate courts' function is to remedy errors of law. Courts without effective appellate review may practice "judicial despotism," as the 50th Congress' report put it. H.R.Rep. No. 942, 50th Cong., 1st Sess. 4 (1888). Not far from the power to review judgments is the power to decide, after *repeated* misapplication of the law by the district judge, that correction of the error requires reassignment. It is repeated and systematic errors of law that create the appellate grounds for reassignment through extraordinary writs. *See, e.g., Will v. United States,* 389 U.S. 90, 102–05, 88 S.Ct. 269, 277–78, 19 L.Ed.2d 305 (1967).

This practice, predicated upon the All Writs Act, 28 U.S.C. § 1651, requires at least a motion to recuse below, or in the case of mandamus or prohibition, notice to the trial judge. *See* Fed.R.App. P. 21; *see also Rapp v. Van Dusen,* 350 F.2d 806, 812 (3rd Cir.1965). The reassignment order in *Sobel v. Yeshiva University,* 839 F.2d 18 (2nd Cir.1988), and other recent court of appeals cases violate this norm where neither a motion to recuse nor mandamus was utilized.

F. *Conflict of Interest or Bias*

The distinction between erroneous application of the law and bias parallels the distinction between appeal and mandamus. In the federal courts the question of bias is explicitly left up to the individual judge to decide in the first instance. Review exists because of the obvious danger that an interested judge will conceal or deny his or her bias, but the system requires that each judge first be given the opportunity to determine his or her own capacity. Congress maintained the present system despite a 1961 recommendation from the Judicial Conference of the United States that the trial judge not pass first on the question of recusal. *See* 13A Wright & Miller, *Federal Practice and Procedure* § 3551 n. 10 (2d ed. 1984).

The recusal statutes instruct the judicial officer on the circumstances which require disqualification. *See* 28 U.S.C. § 455. A party who believes that the judge has not recused himself when he should have may file an affidavit stating the facts and the reasons for the belief that bias or prejudice exists. *See* 28 U.S.C. § 144. Both statutes suggest that the question of recusal lies initially in the district court's domain. They do not set forth bias as a ground for appellate review of the judgment; rather, they force the litigant to put the question of bias to the district judge and then appeal. *See United States v. Olander,* 584 F.2d 876, 883 (9th Cir.1978); *United States v. Mitchell,* 377 F.Supp. 1312 (D.D.C.1974), *aff'd,* 559 F.2d 31 (D.C.Cir.1976), *cert. denied,* 431 U.S. 933, 97 S.Ct. 2641, 53 L.Ed.2d 250 (1977).

Denial of the motion is not a final order appealable as of right. *See* 13A Wright & Miller, *Federal Practice and Procedure* § 3553 at 659 (2d ed. 1984). For the court of appeals to have jurisdiction, there must be a judgment to be appealed. Certification for interlocutory appeal under 28 U.S.C. § 1292(b) is unusual because rarely does a judge's refusal to disqualify raise "a controlling question of law as to which there is substantial ground for difference of opinion." Increasingly the courts of

appeals have had recourse to their mandamus power to order the disqualification of a judge who has wrongfully refused to recuse himself if the petitioner has "satisfied the burden of establishing that its right [to the writ] is clear and indisputable." *In re IBM Corporation,* 618 F.2d 923, 926–27 & n. 3 (2d Cir.1980).

The limited scope of review afforded the court of appeals requires it to decide whether the judge abused his discretion by not recusing himself. *See, e.g., Johnson v. Trueblood,* 629 F.2d 287, 290 (3d Cir.1980), *cert. denied,* 450 U.S. 999, 101 S.Ct. 1704, 68 L.Ed.2d 200 (1981); *United States v. Haldeman,* 559 F.2d 31, 139 & n. 359 (D.C.Cir.1976), *cert. denied,* 431 U.S. 933, 97 S.Ct. 2641, 53 L.Ed.2d 250 (1977). On a motion for recusal, the standard for determining "impartiality" is whether it might "reasonably be questioned." 28 U.S.C. § 455(a). One court recently articulated this standard as being "whether an objective, disinterested observer fully informed of the facts underlying the grounds on which recusal was sought would entertain a significant doubt that justice would be done in the case." *Pepsico, Inc. v. McMillen,* 764 F.2d 458, 460 (7th Cir.1985) (deciding request for mandamus). *See also United States v. Carmichael,* 726 F.2d 158 (4th Cir.1984); *United States v. Nelson,* 718 F.2d 315 (9th Cir.1983); *In re IBM,* 618 F.2d 923, 929 (2d Cir.1980) ("section sets up an objective standard for recusal, creating the so-called 'appearance of justice' rule").

The recusal statutes are not to be abused by parties making motions for tactical reasons which would result in wasted judicial resources. In *New York City Housing Development Corporation v. Hart,* 796 F.2d 976 (7th Cir.1986), the Seventh Circuit found a district court judge's recusal unwarranted by statute, declared the judge qualified to hear the case and left the question of his reassignment to the case in "the sound discretion of the Executive Committee of the District court." *Id.* at 981. In *Hart,* the district court judge had originally denied the disqualification motion because he believed it had been made solely for tactical reasons. 796 F.2d at 978.

Hart emphasizes the importance of not transferring cases from one judge to another without good cause. As the appeals court noted, sanctioning a practice of "ready recusal, coupled with a rule that requires the judge to whom the case is reassigned to revisit all of the rulings after the filing of the motion to disqualify, would multiply the work of judges who already have much to do." 796 F.2d at 981. In *United States v. Murray,* 762 F.2d 1013 (Table) (6th Cir.1985) (unpublished opinion available on Westlaw), the court of appeals, affirming the denial of a recusal motion which challenged the judge who ruled on the suppression motion on the ground that he had earlier authorized the wiretap, stated: "The frequent recusal of judges in such situations could lead to serious procedural headaches for the federal court system. Such a practice might even encourage an unjust form of judge-shopping." *See also In re IBM Corporation,* 618 F.2d 923, 934 (2d Cir.1980) (refusing to order disqualification because it "would result in the waste ... [of] the past decade ... of judicial time and energy....").

A busy district court cannot accept unwarranted recusals or changes in judges' assignments; they place extra burdens on the other judges

FOIA # 57720 (URTS 16[illegible]6) DocId: 70105318 Page 363

and waste scarce judicial resources. "The district judge is, of course, obligated not to recuse himself without reason just as he is obligated to recuse himself when there is reason." *Suson v. Zenith Radio Corporation,* 763 F.2d 304, 308–09 n. 2 (7th Cir.1985).

The existence of the recusal statutes indicates why decisions such as *United States v. Diaz,* 797 F.2d 99 (2d Cir.1986), are inappropriate. In *Diaz* the trial judge was not asked to recuse himself. On the basis of the trial judge's apparently having written a letter to a senator about the violent-felon sentencing statute, the appellate court ordered reassignment. Reassignment was ordered by the panel without any judgment, erroneous or not, by the district judge on the point of bias. As a result, the trial judge was not given the opportunity of providing the record needed for a proper decision on the issue of bias.

One panel went even further in *United States v. Pugliese,* 805 F.2d 1117 (2d Cir.1986), in which it held that although the sentencing judge's denial of defendant's motion of recusal was proper, reassignment on resentencing was required since certain of the judge's statements at sentencing concerning the presentence report "call into question [the] sentencing judge's impartiality, and thus cast doubt on the fair and impartial administration of justice...." 805 F.2d at 1124. Apparently the panel applied a lesser and more vague standard to the remand for resentencing before a different judge than it did to the motion for recusal. Recusal was not required because the challenged statement concerned matters that the sentencing judge learned of in his judicial capacity, but resentencing before another judge was ordered by the court of appeals panel, despite the fact that this change was contrary to the then Eastern District practice.

United States v. Robin, 545 F.2d 775 (2d Cir.1976), *reh'g denied,* 553 F.2d 8 (2d Cir.1977) (en banc), further illustrates the treatment of the recusal statutes on remand. In *Robin,* the court of appeals, recognizing that "an erroneous impression may have been left as to our reasons for such directions in a few cases," 553 F.2d at 9, set forth "guidelines" for determining when reassignment is desirable. *Id.* at 11. The principal factors the court of appeals found relevant to reassignment for resentencing in a case where recusal is not required by 28 U.S.C. § 144 are:

> (1) whether the original judge would reasonably be expected upon remand to have substantial difficulty in putting out of his or her mind previously-expressed views or findings determined to be erroneous or based on evidence that must be rejected, (2) whether reassignment is advisable to preserve the appearance of justice, and (3) whether reassignment would entail waste and duplication out of proportion to any gain in preserving the appearance of fairness.

United States v. Robin, 553 F.2d at 10 (2d Cir.1977) (en banc). The judges of the Eastern District of New York have given careful consideration to these suggested "guidelines." Since they can be taken to apply to almost any case of resentencing on remand, the Eastern District's own Guidelines were changed to require resentencing by another judge as the norm. *See* Guidelines for the Division of Business, Eastern District of New York, Guideline 50.2(l) (revised Feb. 17, 1988).

The suggestion by the court of appeals in *Robin* that a new judge would be unaware of "previously expressed views or findings" on the "mind" of another judge of the district court strains credulity. Most matters of interest in administering the court are shared. And, of course, all judges read the opinions of the courts of appeals, so they all would be aware of any fact relied upon by the court of appeals as a basis for suggesting reassignment.

The federal system assumes that district judges are capable of understanding and executing a mandate even when they disagree with it. What a judge would "have substantial difficulty in putting out of his or her mind," *Robin,* 553 F.2d at 10, is a question normally best posed by a litigant, who has a stake in the problem of bias, and can move for recusal. It is better answered in the first instance by the trial judge—the person who knows the limits of his or her own objectivity. The effect on the other judicial business of the court of any transfer from one judge to another can be determined most readily by those responsible for the business of the court, at the trial, not the appellate, level.

Yet several Circuits continue to intrude on the assignment of district judges even in the absence of motions for recusal in the trial court. In *United States v. Sears,* 785 F.2d 777 (9th Cir.), *mandamus denied sub nom. In re Real,* 479 U.S. 982, 107 S.Ct. 604, 93 L.Ed.2d 604 (1986), the Court of Appeals for the Ninth Circuit addressed the problem of the recusal statutes and assumed that it had the power to order reassignment without notice to the district judge:

> We are not acting under the disqualification statutes, which a party must first invoke before the district court. Instead, this court is being asked in the first instance to exercise its inherent power to administer the system of appeals and remands by ordering a case reassigned on remand. The basis for the reassignment is not actual bias on the part of the judge, but rather a belief that the healthy administration of the judicial and appellate processes, as well as the appearance of justice, will best be served by such reassignment. We do not believe that the statutory provisions concerning disqualification are either exhaustive or the exclusive method whereby a judge may be removed from hearing a case.

785 F.2d at 780. *See also, United States v. Jacobs,* 855 F.2d 652 (9th Cir.1988); *Brown v. Baden,* 815 F.2d 575, 576 (9th Cir.), *cert. denied,* — U.S. —, 108 S.Ct. 450, 98 L.Ed.2d 390 (1987); *Antron v. Union Pac. R.R. Co.,* 813 F.2d 917, 921 (9th Cir.1987). Although the Ninth Circuit may have been correct in stating that the recusal statutes are not the only way to disqualify a judge, it has made no adequate argument based on its statutory or historical authority to defend its acting outside those statutes.

Pressing further, the Second Circuit has taken upon itself the occasional role of ordering reassignments even when there is not the slightest evidence of any bias or error by the trial judge. In *United States v. Corsentino,* 685 F.2d 48 (2d Cir.1982), the appellate court granted a motion to vacate a sentence and ordered resentencing before another judge, although "the need for resentencing was caused entirely by the

FOIA # 57720 (URTS 1632) DocId: 70105318 Page 364

prosecutor [who violated the plea agreement] and is not attributable to the sentencing judge." 685 F.2d at 52. *See also United States v. Chitty*, 760 F.2d 425, 432 (2d Cir.), *cert. denied*, 474 U.S. 945, 106 S.Ct. 310, 88 L.Ed.2d 287 (1985) (ordering remand to another judge, because of prosecutor's remarks, even "though obviously not the fault of" the judge); *United States v. Carbone*, 739 F.2d 45 (2d Cir.1984) (rule 35 motion predicated on prosecutor's violation of plea agreement to be heard by another judge).

The trial court is sensitive to the need to reassign some Rule 35 motions for resentencing, depending on their basis. *See United States v. Stolon*, 561 F.Supp. 63, 64–66 (E.D.N.Y.1983). A rule which would require automatic reassignment of Rule 35 motions does not serve the interests of judicial economy and will often be contrary to the interests of justice. But the decision should be made in the first instance at the trial, not the appellate level. *See United States v. Arnett*, 628 F.2d 1162, 1165 (9th Cir.1979) ("remand to a new judge is reserved for 'unusual circumstances' "). *Cf. Koller v. Richardson–Merrell*, 737 F.2d 1038, 1067 (D.C.Cir.1984) (Richey, J., concurring) ("even the suggestion of remanding the case to another judge is inappropriate"), *vacated on other grounds*, 472 U.S. 424, 105 S.Ct. 2757, 86 L.Ed.2d 340 (1985); *Nobel v. Morchesky*, 697 F.2d 97, 103 n. 11 (3d Cir.1982) ("mandatory reassignments should be made infrequently and with the greatest reluctance").

The recusal process was created for good reasons. Appellate circumvention of that process can only injure our ability to secure justice. I agree with Judge Richey's ringing conclusion:

> The time has come to implement the mandate of Congress and remand cases to a different judge *only* on the basis of evidence that would require recusal under 28 U.S.C. §§ 144 and 455. Otherwise, we will be opening a 'Pandora's Box' for countless baseless attacks upon a defenseless judiciary whose independence is essential to the preservation of this republic.

Koller v. Richardson–Merrell, 737 F.2d 1038, 1067 (D.C.Cir.1984) (Richey, J., concurring) (emphasis in original), *vacated on other grounds*, 472 U.S. 424, 105 S.Ct. 2757, 86 L.Ed.2d 340 (1985). I would add to Judge Richey's remarks that the evidence for recusal must first be presented on motion to the trial judge. In short, absent repeated deliberate errors warranting the issuance of an extraordinary writ, the appellate panels ought never order reassignment on remand without observing the statutory recusal process.

V. CONCLUSION

Peremptory reassignments such as those in *United States v. Pugliese*, *United States v. Diaz*, and *Sobel v. Yeshiva University*, where claims concerning the trial judge's impartiality are made in the first instance in or by the appellate court, distort the statutorily prescribed recusal remedy as well as the All Writs Act. Such reassignment interferes with the docket of the district court where the district judge has neither exceeded his or her authority nor refused to exercise that authority (the

standard under *Will v. United States*), nor demonstrated an inability to execute the appellate mandate (the reasoning of *Sears*). It is a gratuitous gesture without authority to support it except in recent appellate decisions that themselves lack adequate legal basis. It runs the risk of masking unauthorized "[s]entence review." *United States v. Robin*, 545 F.2d 775, 782 (2d Cir.1976) (Timbers, J., dissenting), *reh'g. denied*, 553 F.2d 8 (2d Cir.1977) (en banc). It creates "the potential for havoc ... upon the effective administration of justice in the trial court." *Koller v. Richardson–Merrell*, 737 F.2d 1038, 1067 (D.C.Cir.1984) (Richey, J., concurring), *vacated on other grounds*, 472 U.S. 424, 105 S.Ct. 2757, 86 L.Ed.2d 340 (1985).

Despite the court of appeals' lack of authority to issue orders for reassignment, the judges of the district courts have generally followed the advice of the Circuits in these cases in a show of collegiality. The recent revision of Guideline 50.2(*l*) in the Eastern District of New York should avoid in the future the embarrassment that such unwarranted orders have caused both courts.

We need not consider at this time the limits on the powers of the Circuit judicial councils to order reassignments when the trial judge has received notice that this issue will be pursued on appeal. *See, e.g., Chandler v. Judicial Council of the Tenth Circuit*, 398 U.S. 74, 90 S.Ct. 1648, 26 L.Ed.2d 100 (1970); Wallace, *Judicial Administration in a System of Independents: A Tribe with Only Chiefs*, 1978 Brigham Young L. Rev. 39, 47; Note, *Unnecessary and Improper: The Judicial Councils Reform and Judicial Conduct and Disability Act of 1980*, 94 Yale L.J. 1117, 1124–25 (1985). The Circuit judicial councils have generally been quite careful and have not attempted to interfere with the assignment of trial judges. Were they to do so, the district judges, I am confident, would resent this attack on their independence. *See, e.g.*, the article by District Judge Frank Battisti, *An Independent Judiciary or and Evanescent Dream*, 25 Case Western Reserve L.Rev. 711 (1975), decrying the circuit councils' attempts to remove judges outside the impeachment process.

Since the abuses to date have been by only a relatively few judges of the courts of appeals, it is my hope that neither the councils nor individual courts of appeals panels will attempt to flout the present historical and statutory scheme, but, instead, that they will leave the division of business among district courts to the judges of the district courts. For much the same reason that it would be unheard of for the Supreme Court to remand a case to the court of appeals with *sua sponte* instructions that certain court of appeals judges should not participate in the case, so judges of the courts of appeals should refrain from this practice when remanding to the district courts. One of the great strengths of the federal judicial system has been the strong sense of independent power and responsibility of each federal judge to protect the Constitution and laws of the United States. Any unnecessary erosion of this vital legal resource can only be deprecated and viewed with alarm.

FOIA #57720 (URTS 163) DocId: 70105318 Page 365

APPENDIX

GUIDELINES FOR THE DIVISION OF BUSINESS UNITED STATES DISTRICT COURT EASTERN DISTRICT OF NEW YORK

ADOPTED PURSUANT TO 28 U.S.C. § 137

50.1 CATEGORIES AND CLASSIFICATION OF CASES; INFORMATION ON CASES AND PARTIES

(a) *Categories of cases.* Cases shall be divided into the following main categories:

(1) civil

(A) regular

(B) multidistrict litigation

(2) criminal

(3) miscellaneous

(b) *Information sheet.* The party filing the initial paper in a civil or criminal case shall complete and attach an information sheet. The information sheet shall be placed in the case file.

(c) *Disclosure of interested parties.* To enable judges and magistrates to evaluate possible disqualification or recusal, counsel for a private (nongovernmental) party shall submit at the time of initial pleading a certificate identifying any corporate parent, subsidiaries, or affiliates of that party.

(d) *Long Island cases.*

(1) A criminal case shall be designated a "Long Island case" if the crime was allegedly committed wholly or in substantial part in Nassau or Suffolk County.

(2) A civil case shall be designated:

(A) a "Uniondale case" if the cause arose wholly or in substantial part in Nassau County, or all or most of the parties reside in that county; or

(B) a "Hauppauge case" if the cause arose wholly or in substantial part in Suffolk County, or all or most of the parties reside in that county.

(3) As provided in 50.2(f) a party may move to designate a case as a Long Island case, a Uniondale case or a Hauppauge case or to cancel such designation on the grounds that such action will serve the convenience of the parties and witnesses or is otherwise in the interests of justice.

(e) *Miscellaneous cases.* All matters that do not receive a civil or criminal docket number shall be given a miscellaneous docket number

APPENDIX—Continued

and assigned to the miscellaneous judge. The matter will continue to be assigned to that judge after he or she ceases to be miscellaneous judge.

50.2 ASSIGNMENT OF CASES

(a) *Time of assignment.* The clerk shall assign a civil case upon the filing of the initial pleading. In a criminal case after an indictment is returned or after an information (including a juvenile information under 18 U.S.C. § 5032) or a motion to transfer under 18 U.S.C. § 5032 has been filed, the United States Attorney shall refer the case to the clerk who shall then assign the case. The United States Attorney shall arrange with the judge to whom the case is assigned, or if that judge is absent or unavailable as provided in 50.5, with the miscellaneous judge, to have the defendant arraigned and a plea entered as promptly as practicable.

(b) *Random selection procedure.* All cases shall be randomly assigned by the clerk or his designee in public view in one of the clerk's offices in such a manner that each active judge shall receive as nearly as possible the same number of cases, except as provided in paragraph (h). Where a party or his counsel requests prior to selection that he or she be present at the selection, the clerk shall make reasonable efforts to comply with the request. In Brooklyn civil cases a magistrate shall be drawn at the same time and in the same manner as a judge. All Long Island civil cases shall be assigned to the Long Island magistrate. The parties to any Long Island case assigned to a Brooklyn judge may stipulate that the case be assigned to the Long Island magistrate for pretrial purposes.

(c) *Assignment of civil cases.* There shall be separate Brooklyn, Uniondale and Hauppauge civil assignment wheels. At least quarterly the Chief Judge shall fix the proportion of cases to be assigned to the Long Island courthouses so as to distribute the civil cases relatively equally among all the active judges.

(d) *Assignment of criminal cases.*

(1) There shall be a Brooklyn criminal and a Long Island criminal assignment wheel.

(2) There shall Brooklyn and Long Island criminal misdemeanor assignment wheels for the random assignment of these matters to a magistrate.

(e) *Place of trial.* Except in emergencies a case shall be tried at the place to which it has been assigned.

(f) *Objection.* Any objection by a party to designation of a judge or to place of trial shall be made by letter or motion to the judge assigned

(1) in a criminal case, within ten days from arraignment or from initial notice of appearance, whichever is earlier; or

(2) in a civil case, within the time allowed to respond to the complaint.

(g) *Special cases.*

(1) The miscellaneous judge shall send all narcotics addict commitment cases involving "eligible individuals" as defined by 28 U.S.C. § 2901(g) to the clerk for assignment as provided in paragraph (b).

FOIA # 57720 (URTS 16 DocId: 70105318 Page 366

APPENDIX—Continued

(2) Pro se applications or claims by persons in custody shall be filed without prepayment of fees upon receipt, prior to decision on their in forma pauperis petitions.

(3) Multidistrict litigation is to be assigned to the judge selected by the multidistrict litigation panel and may not be reassigned except by that panel.

(h) *Chief judge; senior judges; temporarily overloaded judges; notice of removal from wheel.* The chief judge and each senior judge shall indicate from time to time to the clerk the percentage of a full caseload that he or she elects to have assigned. The chief judge, with the consent of a judge, may remove that judge from any wheel temporarily to reduce the number of pending cases and prevent delay in the disposition of cases by a judge who is then overburdened by cases or due to ill health. The chief judge shall return that judge to the wheel only on consent of the judge. The clerk shall upon request inform any attorney or party of the identity of judges whose names have been removed from a wheel.

(i) *Visiting judge.* The chief judge shall approve the assignment or transfer of cases to a visiting judge.

(j) *Proceedings after assignment.* All proceedings in a case after assignment shall be conducted by the assigned judge, except as provided by these guidelines.

(k) *Recusal.* A judge or magistrate may recuse himself or herself at any time in accordance with U.S.C. § 455. This guideline takes precedence over any other guideline.

(l) *Appeals—Assignment on reversal or remand.*

(1) In a criminal case upon reversal of a judgment and a direction for retrial or resentence, on receipt of the mandate of the appellate court the clerk shall randomly select a different judge to preside over the case. Notwithstanding this provision the chief judge may order the case assigned to the original presiding judge to avoid placing an excessive burden on another judge.

(2) In a civil case upon reversal the case shall remain assigned to the judge who was previously assigned, unless the chief judge or his designee orders otherwise.

50.3 RELATED CASES; MOTION FOR CONSOLIDATION OF CASES

(a) *"Related" case defined.* A case is "related" to another for purposes of this guideline when, because of the similarity of facts and legal issues or because the cases arise from the same transactions or events, a substantial saving of judicial resources is likely to result from assigning both cases to the same judge and magistrate.

(b) *Civil cases.* By way of illustration and not limitation, the following civil cases are "related": when a case (A) relates to property involved in an earlier pending suit, or (B) involves the same factual issue or grows out of the same transaction as does a pending suit, or (C) involves the validity or infringement of a patent already in suit in a prior case.

(c) *Criminal cases.* Criminal cases are "related" only when (A) a superseding indictment or information is filed, or (B) more than one indictment or information is filed against the same defendant or defendants, or (C) when an application is filed by a person in custody that relates to a prior action. Other cases will be deemed "related" only upon application by a party, upon notice, to the judge presiding over the earlier assigned case. The application will be granted if a substantial saving of judicial resources is likely to result from assigning both cases to the same judge.

APPENDIX—Continued

(d) *Designation of related case.* If the party filing a case believes it to be related to a prior case, whether pending or closed, the party shall so indicate on the information sheet, specifying for each such case the title and the docket number, if any. Each attorney in a case has an ongoing duty to advise the clerk in writing upon learning of any facts indicating that his or her case may be related to any other pending case.

(e) *Assignment of related case.* Related cases shall be assigned by the clerk to the judge to whom was assigned the case with the lowest docket number in the series of cases. The clerk shall advise the judge of such assignment of a "related case."

(f) *Case erroneously assigned as related.* The designation of cases as related may be corrected *sua sponte* by the judge to whom they are assigned, by returning to the clerk for reassignment cases erroneously so assigned. The failure to assign related cases appropriately shall be corrected only by agreement of all of the judges to whom the related cases are assigned; if they agree, they may transfer the later-filed cases as provided in paragraph (e), and notify the clerk of that action.

(g) *Credit for related case.* A related case transferred or assigned to a judge shall be counted as would a newly-filed case regularly assigned. A judge shall be assigned an additional case for each case transferred from him or her under this guideline.

50.4 REASSIGNMENT OF CASES

No case shall be reassigned except in the interest of justice and the efficient disposition of the business of the court. The chief judge may at any time, with the consent of the judges involved, reassign individual cases. Reassignment of cases to accommodate changes in the complement of judges shall be made in accordance with the order of the Board of Judges.

50.5 MISCELLANEOUS JUDGE

(a) *Duties and functions.* A miscellaneous judge shall be designated for each session of the court to:

(1) hear and determine:

(A) matters requiring immediate action in cases already assigned to any judge of the court, if that judge is unavailable or otherwise unable to hear the matter;

(B) special proceedings which cannot be assigned in the ordinary course, including motions under Fed.R.Crim.Proc. 41 made prior to indictment;

(C) any other proceeding not part of or related to a case, including admissions to the bar and naturalization proceedings;

FOIA # 57720 (URTS 16) DocId: 7010518 Page 367

APPENDIX—Continued

(D) requests to be excused from service on the grand and petit juries; and

(E) all matters relating to proceedings before the grand jury;

(2) impanel the grand jury, receive indictments, and refer criminal cases to the clerk for assignment pursuant to 50.2.

(b) *Emergency matters.* The miscellaneous judge shall dispose of matters under paragraph (a)(1) only to the extent necessary and shall continue the case before the assigned judge. All applications for emergency action or relief shall disclose any prior application to a judge for the same or related relief and the outcome thereof.

50.6 CALENDARS

(a) *Numbers; Order of cases.* The docket number of each case shall be the calendar number. No note of issue shall be required to place the case on the calendar. Each judge shall dispose of cases assigned to him or her as required by law and the efficient administration of justice.

(b) *Preferences.* Each judge shall schedule cases appearing on his or her docket in such order as seems just and appropriate, giving preference to the processing and disposition of the following:

(1) habeas corpus petitions and motions attacking a federal sentence;

(2) proceedings involving recalcitrant witnesses before federal courts or grand juries, under 28 U.S.C. § 1846;

(3) actions for temporary or preliminary injunctive relief; and

(4) any other action if good cause is shown.

(c) *Publication of calendars.* Each court day the clerk shall post on bulletin boards throughout the courthouse and provide to legal newspapers for publication copies of the judges' calendars.

50.7 CONFERENCES

The judge assigned to any case may direct the attorneys to appear to discuss the case informally, to entertain oral motions, to discuss settlement, or to set a schedule for the events in the case, including completion of discovery, pretrial and trial.

GUIDELINES FOR THE DIVISION OF BUSINESS AMONG UNITED STATES DISTRICT COURT JUDGES FOR THE EASTERN DISTRICT OF NEW YORK PURSUANT TO 28 U.S.C. § 137

COMMENTARY

by

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and

LAWRENCE J. ZWEIFACH, ESQ.

INTRODUCTION

In 1988 the Board of Judges of the United States District Court for the Eastern District of New York, pursuant to 28 U.S.C. § 137, adopted Guidelines for the Division of Business among United States District Court Judges. The Guidelines supersede the Court's Rules for the Division of Business among District Judges. The Guidelines were adopted on February 16, 1988, effective March 31, 1988. They were preceded by publication of proposed guidelines and many conferences with members of the bar and bar association committees.

The Guidelines for the Division of Business among United States District Court Judges are in part an outgrowth of the work of the Court's Criminal Procedure Committee, which was appointed by Chief Judge Jack B. Weinstein in the Fall of 1985. Reports of the Criminal Procedure Committee appear at 111 F.R.D. 303 and 311 (1986); these reports were not themselves approved by the Board of Judges and are cited here for informational and historical purposes only. Also part of the history of the Guidelines are letters to Chief Judge Weinstein from the Criminal Procedure Committee (October 8, 1987) and from the Committee on Federal Courts, Association of the Bar of the City of New York (October 6, 1987), commenting on a May 1987 draft of proposed Guidelines, and from the Committee on Federal Courts (January 8, 1987), commenting on the reports of the Criminal Procedure Committee. The Criminal Procedure Committee reports had been well-publicized, appearing not only in Federal Rules Decisions but in the *New York Law Journal* as well (June 18, 1986; digest published on June 17, page 1). Comments on the reports were received from practitioners, and matters covered by the proposed Guidelines were discussed at retreats of the judges of the court held during the Judicial Conferences of the Second Circuit in 1986 and 1987 and at subsequent meetings of the Board of Judges. In short, the Guidelines are the product of a dialogue among the judges, practitioners, and bar organizations.

This Commentary was prepared by Lawrence J. Zweifach, Esq., Chairman of the Criminal Procedure Committee and Prof. Peter Lushing, the

FOIA # 57720 (URTS 16[illegible]) DocId: 70105318 Page 368

Committee Reporter, with the assistance of Douglas C. Dodge, District Executive of the Court, and has been reviewed by the Chief Judge.

50.1

(a) Rule 1 of the Rules for the Division of Business among District Judges (hereinafter "DR") categorized cases as Bankruptcy, Civil, or Criminal. With the restructuring of the bankruptcy court system in 1978, the District Court no longer sees enough original bankruptcy filings to make a separate category necessary. There are also bankruptcy court rules now. The new miscellaneous and multidistrict categories in the Guideline (hereinafter "GL") codifies existing practice.

(b) The first sentence carries over DR 1(b), except that the new category of miscellaneous cases does not require an information sheet, because many miscellaneous cases involve ministerial matters such as filing an abstract of judgment from another court. The new provision that the information sheet shall be filed codifies the existing practice of the clerk's office. The information sheet is of substantial importance, see GL 50.2(f), and the GL's reflect the fact that the sheet must be on file in order to give notice to all parties of case designations. A suggestion that the information sheet be given to defense counsel along with the indictment was rejected as unnecessary.

(c) This paragraph appears in General Civil Rule 9 and is included here as the logical location for requirements affecting the commencement of an action.

(d) Designation of Long Island criminal cases is unchanged from DR 1(c)(1). Long Island civil cases are now subdivided into the locations of the courthouses on Long Island, the Hauppauge Courthouse not being in existence when the DR's were promulgated. The criteria for discretionary designation or cancellation of designation as a Long Island case are unchanged from DR 1(c)(3). A cross-reference to a uniform procedure for objections to case designations is given.

(e) Miscellaneous matters such as non-party motions to quash subpoenas are not categorized as civil or criminal cases and are referred to the miscellaneous judge. To avoid any question on a sensitive topic, the GL makes it clear that a miscellaneous matter follows the judge, not the miscellaneous part.

50.2

(a) Unchanged from DR 2(a).

(b) DR 2(b) required the judges to determine the method of random selection of cases and provided other details on the mechanics of assignment. The GL removes some of the formal requirements as unnecessary and provides for the first time that cases shall be assigned in public view in the clerk's office. There was a widespread and deeply held feeling among criminal defense practitioners that assignment of a judge to the case was an important and sensitive step in the litigation and should therefore be performed in public. In fact it was already the practice of the clerk's office to allow counsel to attend the drawing of the judge's name from the assignment drum, but many argued that attorneys unfamiliar with with the practices of the court would not be aware of the opportunity to attend the assignment—hence this restatement of the

EOA # 572040 URTS 16[illegible] DocId: 70105318 Page 369

practice. A recommendation by the Criminal Procedure Committee that the assignment be in open court was rejected as cumbersome and having no additional utility.

It will still be up to the attorney to endeavor to be informed as to when the assignment of the judge takes place. In civil actions the assignment occurs when the complaint is filed, so defendant's eventual counsel will be present at this event only by accident, as it were. But in criminal cases many defendants will have retained counsel or have been assigned the Legal Aid Society prior to indictment, and by dint of counsel's communications with the Assistant United States Attorney and the clerk's office there often can be some assurance that counsel will be aware of the impending filing of the indictment. Counsel will therefore be able to attend the drawing of the judge. This will be mostly in cases where the prosecutor does not intend to have the defendant arrested, for in arrest cases the indictment is usually sealed until the arraignment with the defendant safely in custody, an arrest warrant having been issued when the indictment was handed up to the court *in camera*. Meanwhile, the judge will have been drawn in secret, and the docket sheet will have been sealed.

In any event this GL should not be construed either as creating any right to be informed of the time of the drawing of the judge or as furnishing any ground for vacating a judgment, vacating an assignment, or any other remedy because of a failure to be informed of the time of the drawing.

The provision on assigning magistrates in Brooklyn civil cases is new and reflects a practice followed for over three years and which was inaugurated through the promulgation of the Standing Orders on Effective Discovery in Civil Cases (Standing Order 4 provides in part that "a magistrate shall be assigned to each case at random on a rotating basis upon the commencement of an action...."). On Long Island there is at present only one magistrate.

(c) Substantially unchanged from DR 2(c). The separate wheels for civil cases reflects the assignment of judges to the several courthouses. Distribution of cases "relatively equally" is a more realistic goal than the terminology of the DR.

(d) DR's did not provide for judge assignment of criminal cases as "Long Island," although that case-designation category did in fact exist. For some time there has been more than one judge assigned to Long Island, but the DR's had not reflected that fact. As there is only one judge in Hauppauge at present, there should only be one criminal assignment wheel for all of Long Island to afford a random selection process for criminal cases, where the bar is most sensitive about judge selection. Proposals to add a category of criminal "complex" cases, or even "short," "medium," and "long" case categories, which were intended to spread the workload evenly among the judges, were rejected as an unnecessary and complicating refinement. Cf. GL 50.2(h).

(e) DR 2(c) gave the assigned judge discretion to designate the place of trial. The existence of such discretion is contrary to the purpose of geographical case designations and assignment wheels, as well as to the

rationale for a proposed change in jury wheels under which Brooklyn courthouse jurors will come only from non-Long Island counties. The GL provides an exception only for emergencies, and even those exceptions may be challenged under paragraph (f).

(f) DR's regulated objections to designations and assignments in various places; e.g., DR's 1(c), 2(c), 4(b). The GL provides a single format for objection and sets short time limits, precisely measurable, for the making of objections so that the issue can be resolved before substantial expenditure of judicial energy. This provision includes objections to the designation of cases as related or to failure to so designate under 50.3.

(g) Paragraphs (1) and (2) substantially restate DR 2(d)(1) and (2) The subject matter of DR 2(d)(3) is treated in GL 50.2(*l*). Paragraph (3) of the GL is in accord with the Manual for Complex Litigation, Second, § 31.121, at 253 (1985).

(h) The first sentence substantially restates DR 2(f). The provisions on removal and restoration of judges to a wheel serve to regularize those practices. The last sentence affords any practitioner before the court equal access to information that often is available only to institutional litigants who are constantly in attendance at the courthouse, such as the United States Attorney and the Legal Aid Society. Many attorneys believe that the status of judges in the wheels is important and unnecessarily recondite and, as "hidden information," could be used to manipulate the assignment of judges by influencing the chosen designation of a case; the GL is intended to assuage these anxieties. A proposal to publish the status of judges in the assignment wheels in the *New York Law Journal* was rejected as useless, given the time lag between the change of status and the eventual publication.

(i) This regularizes and restates existing practice.

(j) This is a restatement of DR 2(g).

(k) This paragraph simply alerts the practitioner to the overriding statute. See also 28 U.S.C. § 144 (recusal on motion).

(*l*) DR 2(d)(3) provided for reassignment of civil and criminal cases sent back by an appellate court for retrial, unless the mandate of the appellate court directed otherwise. In fact the practice under the DR was to reassign mechanically only criminal cases, and only those to be retried. The GL draws a distinction between remand in civil and criminal cases, and provides for reassignment of civil cases on remand only in the discretion of the chief judge. Knowledge that a case would be retried by the same judge is believed to have a possible inhibiting effect on vigorous appellate advocacy. In civil litigation however this danger is thought to be outweighed by considerations of judicial economy, civil litigation often having a plethora of complex rulings and information.

In contrast, as to criminal cases the GL mandates reassignment for retrial or resentence but grants the chief judge discretion to assign the case to the original judge in the interest of substantial administrative savings. For example, if a new judge assigned to resentence were compelled to read a record of a multi-month trial, there might be good grounds for the chief judge to order assignment to the original judge.

The court considered the possibility of explicitly providing that upon stipulation of the parties a criminal case would be sent back to the original judge for retrial after reversal. It omitted such a provision in order not to put pressure on the parties to so stipulate. Upon agreement of the parties and the judge involved this result is not precluded by the Guidelines.

The United States Court of Appeals for the Second Circuit has from time to time directed that a new judge hear a matter, but the source of the court's power to do this in the absence of a recusal issue's being first raised in the court below is unstated and seems dubious. Recent examples include *Sobel v. Yeshiva University*, 839 F.2d 18 (1988); *Outley v. City of New York*, 837 F.2d 587 (1988); *United States v. Pugliese*, 805 F.2d 1117 (1986); and *United States v. Diaz*, 797 F.2d 99 (1986).

No statute authorizes an appellate court to order reassignment for bias as an original matter. 28 U.S.C. § 2106 arguably authorizes an appellate order of reassignment to correct repeated errors of law, but even then only upon notice to the district judge that a petition for mandamus is being filed. The recusal for bias statutes, 28 U.S.C. §§ 144 and 455, seemingly contemplate that the district judge pass upon the issue in the first instance. And even here the scope of appellate review is apparently limited to abuse of discretion.

It is extraordinarily wasteful for a case to be unnecessarily reassigned after remand from an appellate court. This will be especially so under the new sentencing guidelines, which will require many factual inquiries.

Channeling the bias issue before the district court in the first instance affords the judge an opportunity to make a record on the matter. Such channeling further confines the issue to the statutory criterion for bias under §§ 144 and 455 and avoids the use of vague *ad hoc* standards. See *United States v. Pugliese, supra*, where denial of a recusal motion was upheld and yet a necessary resentencing was ordered reassigned to a different judge, apparently under a broader standard than provided by the recusal statutes.

The judges of the Eastern District of New York are mindful of the criteria for reassignment set down in *United States v. Robin*, 553 F.2d 8, 10 (2nd Cir.1977) (per curiam en banc). But it is also the case that any of the judges of the court will be aware of the appellate court's opinion and thus know of the facts that are not to be considered on resentence—and which the original sentencing judge was apparently deemed by the appellate court to be unable to disregard on resentence. A judge is in the best position to know whether he or she can disregard certain facts, and so the question of recusal can properly be left to that judge in the first instance.

The GL therefore effects a sensible compromise between the need for reassignment and the administrative needs of the court. Reassignment in the indicated cases shall be the rule, subject to administrative exception by the chief judge, which exception will itself be subject to overruling by the presiding judge in cases of felt bias.

FOIA # 57720 (COURTS 1) DocId: 7010318 Page 370

50.3

(a) DR 3(a) defined "related" in general discretionary terms to be applied in the first instance by the party filing the case and furnished illustrative examples. This paragraph retains the general definition, but a party acting on its own can apply the definition to civil cases only; see paragraphs (b) and (c).

(b) These examples come from DR 3(a)(1).

(c) DR 3(a)(2) furnishes examples (A) and (B) as illustrative and not by way of limitation. The GL examples are exclusive unless the court grants an application under the discretionary standard. There was some opposition from the bar to retaining the discretionary standard as overly elastic and inviting judge-shopping. However the proposed GL permitted the prosecutor filing the indictment to designate unilaterally the case as "related" under the discretionary criteria; under the GL as promulgated the prosecutor must instead make an application to the judge presiding over the earlier assigned case. The bar was also concerned with counsel's having to oppose the designation before the very judge who might preside over the case, but the Board of Judges felt that that judge was in the best position to apply the standard, as he or she would know the particulars of the "related" case and therefore whether there would be a substantial saving of judicial resources by approving the designation.

(d) The first sentence substantially restates the first sentence of DR 3(b). The second sentence of DR 3(b) is omitted as having little or no application. The second sentence of the paragraph derives from DR 3(f).

(e) This paragraph derives from DR 4(c). The last sentence of DR 4(c) is omitted as redundant to 50.3(b)(B).

(f) This paragraph deals with *sua sponte* challenges to relating or failing to relate cases and substantially restates DR 4(d). Party challenges to unilateral relating or failing to relate cases must be made in accordance with GL 50.2(f).

(g) This paragraph derives from DR 4(e).

50.4

This is a substantial restatement of DR 4(a). The proposed GL granted unlimited discretion to reassign; this raised some concern among the bar so the DR criteria were restored.

50.5

Paragraphs (a) and (b) restate DR 5 (a) and (b); the subject of DR 5(c) is covered by the second sentence of GL 50.5(b). A highly controversial proposal to add an arraignment function to the miscellaneous part was rejected. See the Criminal Procedure Committee Report on the Assignment of Cases to Judges, 111 F.R.D. 307 (1986); Rakoff, *Business Crime*, N.Y.L.J., May 14, 1987, p. 1, col. 1.

FOIA # 57720 (URTS 1632 Docld: 70105318 Page 371

50.6

Paragraphs (a) and (b) restate DR 6(a) and (b). Paragraph (c) is new and restates existing practice. DR 6(d), (e), and (f) are omitted.

50.7

This is a restatement of DR 7.

*

COMMENT

QUESTIONING THE IMPARTIALITY OF JUDGES: DISQUALIFYING FEDERAL DISTRICT COURT JUDGES UNDER 28 U.S.C. § 455(a)

INTRODUCTION

An impartial judiciary is an essential element of the system of justice in the United States. The right to a "neutral and detached judge" in all proceedings is protected by the Constitution.[1] In addition, an impartial judiciary is essential to maintain public confidence in the integrity of the judicial system.[2] Throughout the history of our national government, Congress has sought to secure the impartiality of trial judges by requiring judges to disqualify themselves in various circumstances.[3]

Congress revised the federal disqualification law in 1974, and instituted an objective standard for disqualification in place of a subjective standard.[4] As stated in 28 U.S.C. § 455(a), the objective disqualification requirement mandates disqualification when a reasonable person would question a judge's impartiality.[5]

Since the objective standard was adopted, however, judicial interpretation of section 455(a) has narrowed the broad scope Congress intended for disqualification law.[6] Federal courts have limited the scope of the current statutory provi-

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1. Ward v. City of Monroeville, 409 U.S. 57, 61-62 (1972). *See also* Marshall v. Jerrico, Inc., 446 U.S. 238, 243 (1980) ("powerful" constitutional interest in fair adjudicative procedure); Redish & Marshall, *Adjudicatory Independence and the Values of Procedural Due Process*, 95 YALE L.J. 455, 457 (1986) (independent adjudicator necessary to satisfy due process requirements).

2. *See Judicial Disqualification: Hearing on S. 1064 Before Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 93d Cong., 1st Sess. 1, 75 (1971 and 1973) [hereinafter *Senate Hearing*] (statement of Senator Burdick) (disqualification ensures that judicial decision is not tainted with partiality and thus "enhances public confidence in the judicial system").

3. The first federal disqualification statute disqualified judges from cases in which the judge was "concerned in interest," or had been of counsel for either party. Act of May 8, 1792, ch. 36, § 11, 1 Stat. 278 (1872) (amended and recodified 1911). 28 U.S.C. § 455(b) (1982) requires judges to disqualify themselves on several specified grounds, including financial interest, personal or professional relationships with persons involved in the litigation, or prior involvement in the litigation. *See infra* note 12 for the text of § 455(b). In addition, federal law disqualifies judges in circumstances where a reasonable person would question a judge's impartiality, 28 U.S.C. § 455(a), and specifically disqualifies a judge for bias or prejudice. 28 U.S.C. §§ 144 & 455(b)(1); *see infra* note 35 for the text of § 144, and *infra* note 12 for the text of § 455.

4. *Senate Hearing*, *supra* note 2, at 74 (statement of Senator Burdick); H.R. REP. NO. 1453, 93d Cong., 2d Sess. 1, *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 6351, 6354 [hereinafter *House Report*].

5. 28 U.S.C. § 455(a) (1982). *See infra* note 12 for the text of § 455(a).

6. *See infra* notes 26-30 and accompanying text for a discussion of the congressional intent behind the revision of § 455.

FOIA # 57720 (URTS 16326) Document: 70105318 Page 372

sions by requiring a high standard of proof of bias[7] and by applying judicially-created rules restricting the circumstances in which bias can be found.[8] In addition, the procedures for disqualification cast into doubt the objectivity of disqualification decisions.[9] The procedures allow the challenged judge to make the disqualification decision. If a judge refuses to disqualify himself, review is not always immediately available and appellate courts tend to defer to the initial judgment of the district court.[10]

This comment will review current standards and procedures required by statute and applied to judicial disqualification by the courts. It will assess the extent to which current interpretations conform to the objective standard set forth in section 455(a) and explore ways in which disqualification decisions may be made on a more objective basis.

I. Statutory Provisions for Disqualification

Two provisions of federal law furnish the means for disqualifying district court judges.[11] The paramount disqualification statute is 28 U.S.C. § 455.[12] Section 455(a) sets forth a general provision mandating disqualification whenever a reasonable person would question a judge's impartiality.[13]

Section 455(b) requires disqualification in several specified circumstances.[14] A judge is disqualified if he or she has a financial interest in a case,[15] defined by the statute as "ownership of a legal or equitable interest, however small, or a relationship as director, adviser, or other active participant in the affairs of a party."[16] Section 455(b) also mandates disqualification if the persons involved in the litigation are related to the judge "within the third degree of [blood] relationship."[17] The statute also provides for disqualification if the judge has a professional relationship with a party, including representation of a party by the judge or by a member of the judge's former firm.[18] Judges who have been in government employment must disqualify themselves from proceedings in which they had a role and from cases about which they have expressed an opinion on

7. *See infra* notes 83-108 and accompanying text for a discussion of the standards of proof of bias under §§ 455(a), 455(b)(1) and 144.

8. *See infra* notes 109-94 and accompanying text for a discussion of the judicially-created substantive rules for disqualification.

9. *See infra* notes 23-25, 228-32 and accompanying text for a discussion of disqualification procedures.

10. *See infra* notes 51-88 and accompanying text for a discussion of the availability and standards of review on appeal.

11. 28 U.S.C. §§ 144, 455 (1982). Appellate courts as well as district courts are subject to § 455, while § 144 applies only to district courts. The only other federal disqualification statute applies to appellate courts and provides that "[n]o judge shall hear or determine an appeal from the decision of a case or issue tried by him." 28 U.S.C. § 47 (1982).

12. 28 U.S.C. § 455 (1982) states:

(a) Any justice, judge, or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.

(b) He shall also disqualify himself in the following circumstances:

(1) Where he has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;

(2) Where in private practice he served as lawyer in the matter in controversy, or a lawyer with whom he previously practiced law served during such association as a lawyer concerning the matter, or the judge or such lawyer has been a material witness concerning it;

(3) Where he has served in governmental employment and in such capacity participated as counsel, adviser or material witness concerning the proceeding or expressed an opinion concerning the merits of the particular case in controversy;

(4) He knows that he, individually or as a fiduciary, or his spouse or minor child residing in his household, has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding;

(5) He or his spouse, or a person within the third degree of relationship to either of them, or the spouse of such a person:

(i) Is a party to the proceeding, or an officer , director, or trustee of a party;

(ii) Is acting as a lawyer in the proceeding;

(iii) Is known by the judge to have an interest that could be substantially affected by the outcome of the proceeding;

(iv) Is to the judge's knowledge likely to be a material witness in the proceeding.

(c) A judge should inform himself about his personal and fiduciary financial interests, and make a reasonable effort to inform himself about the personal financial interest of his spouse and minor children residing in his household.

(d) For the purposes of this section the following words or phrases shall have the meaning indicated:

(1) "proceeding" includes pretrial, trial, appellate review, or other stages of litigation;

(2) the degree of relationship is calculated according to the civil law system;

(3) "fiduciary" includes such relationships as executor, administrator, trustee, and guardian;

(4) "financial interest" means ownership of a legal or equitable interest, however small, or a relationship as director, adviser, or other active participant in the affairs of a party, except that:

(i) Ownership in a mutual or common investment fund that holds securities is not a "financial interest" in such securities unless the judge participates in the management of the fund;

(ii) An office in an educational, religious, charitable, fraternal, or civil organization is not a "financial interest" in securities held by the organization;

(iii) The proprietary interest of a policyholder in a mutual insurance company, of a depositor in a mutual savings association, or a similar proprietary interest, is a "financial interest" in the organization only if the outcome of the proceeding could substantially affect the value of the interest;

(iv) Ownership of government securities is a "financial interest" in the issuer only if the outcome of the proceeding could substantially affect the value of the securities.

(e) No justice, judge, or magistrate shall accept from the parties to the proceeding a waiver of any ground for disqualification enumerated in subsection (b). Where the ground for disqualification arises only under subsection (a), waiver may be accepted provided it is preceded by a full disclosure on the record of the basis for disqualification.

13. *Id.* § 455(a).

14. *Id.* § 455(b).

15. *Id.* § 455(b)(4).

16. *Id.* § 455(d)(4).

17. *Id.* § 455(b)(5).

18. *Id.* § 455(b)(2).

FOIA # 57720 (URTS 16326) D[illegible]: 70105318 Page 373

the merits.[19] Section 455(b) also requires disqualification when a judge has "a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding."[20]

Parties cannot waive their right to disqualification when it is based on one of the grounds specified in section 455(b).[21] When the disqualification is based on section 455(a), however, waiver is permitted upon full disclosure of the basis for disqualification.[22]

Section 455 places responsibility for disqualification on the judge.[23] This action can be taken *sua sponte*.[24] Courts also permit disqualification to be prompted by a party either by motion or on appeal.[25]

Section 455 was significantly revised in 1974.[26] A major concern of Congress was to eliminate the subjective opinion of the judge as the basis for determining disqualification.[27] The superseded version of section 455 required

19. *Id.* § 455(b)(3).

20. *Id.* § 455(b)(1).

21. *Id.* § 455(e).

22. *Id.* The waiver provision is an inversion of the waiver provisions of the American Bar Association ("ABA") Code of Judicial Conduct. In the final draft of the ABA Code, waiver of disqualification on grounds of interest or relationship is allowed after full disclosure. CODE OF JUDICIAL CONDUCT Canon 3D (1972). Waiver is not permitted under the general provision that disqualifies the judge whose impartiality is reasonably questioned. *Id.* The ABA's rule was based on the premise that parties should not be permitted to waive a provision designed to promote public confidence in the judiciary. *Senate Hearing*, *supra* note 2, at 109 (Professor Thode, Reporter of the ABA's Special Committee on Standards for Judicial Conduct). The ABA allowed waiver where public confidence in the judiciary would not be affected, and safeguarded the parties by requiring that the waiver be made in writing, rather than orally in the presence of the judge. *Id.* The Senate framers, on the other hand, rejected any waiver of disqualification based on § 455(b) grounds, but allowed waiver of § 455(a) disqualification on the rationale that a judge should be permitted to discuss with the attorneys involved in a case whether the objective standard required disqualification. *Id.* at 112 (Mr. Westphal, chief counsel to the Senate Committee on the Judiciary).

23. 28 U.S.C. § 455(a) ("Any judge . . . shall disqualify himself. . . ."); *id.* § 455(b) ("He shall also disqualify himself. . . .").

24. *See* Roberts v. Bailar, 625 F.2d 125, 128 (6th Cir. 1980) (party need not follow particular procedure under § 455(a); federal judges must observe § 455 guidelines *sua sponte*).

25. Davis v. Board of School Comm'rs, 517 F.2d 1044, 1051 (5th Cir. 1975), *cert. denied*, 425 U.S. 944 (1976).

26. Act of Dec. 5, 1974, Pub. L. No. 93-512, § 1, 88 Stat. 1609 (codified as amended at 28 U.S.C. § 455 (1982)).

27. *Senate Hearing*, *supra* note 2, at 74 (statement of Senator Burdick); *House Report*, *supra* note 4, at 6355. The revisions were also motivated, in part, by a perceived need for clarification of standards that arose from the confirmation hearings for Judge Haynsworth, a Nixon nominee to the Supreme Court who was rejected by the Senate. *Senate Hearing*, *supra* note 2, at 10, 25 (statements of Senators Burdick, Bayh, and Hollings).

Congress also acted to coordinate federal law with revisions in the Canon of Judicial Conduct being developed by the American Bar Association. A tentative draft of the proposed ABA revisions was circulated two months prior to the first Senate hearings on the revisions to § 455, and the bill was delayed until the ABA completed its process of revision. *Senate Hearing*, *supra* note 2, at 2, 74, 78-79 (statements of Senator Burdick and Judge Traynor). The bill's sponsors wanted to minimize discrepancies between federal disqualification law and ABA standards. *Id.* at 74 (Senator Burdick).

The bill's sponsors were also motivated by their perception of heightened public standards of impartiality, *id.* at 10 (statement of Senator Bayh), and noted that the increased number of federal

disqualification if, "in his opinion," it was improper for a judge to sit during the proceedings.[28] Congress replaced this subjective standard with an objective standard that obliges judges to disqualify themselves when their impartiality "might reasonably be questioned."[29] In instituting this objective standard, Congress stressed that it was doing away with the "duty to sit" rule, requiring that a judge should stay with the case when in doubt about disqualification.[30]

The general disqualification standard set forth in section 455(a) cannot be understood without analysis of two other disqualification provisions—section 455(b)(1) and 28 U.S.C. § 144, both of which disqualify a judge for personal bias and prejudice.[31] A party moving for disqualification under section 455(a) frequently seeks disqualification under both sections 455(b)(1) and 144 as well.[32] Furthermore, interpretation of section 455(a) has been shaped by judicial interpretation of section 144, which predated the revised general disqualification

judges gave them the freedom to require stricter standards. *Id.* at 26 (statement of Senator Hollings).

28. The superseded statute read in full:

> Any justice or judge of the United States shall disqualify himself in any case in which he was a substantial interest, has been of counsel, is a material witness, or is so related to or connected with any party or his attorney as to render it improper, in his opinion, for him to sit on the trial, appeal, or other proceeding therein.

Act of June 25, 1948, ch. 646, § 455, 62 Stat. 908.

29. 28 U.S.C. § 455(a); *see supra* note 12 for the text of § 455(a).

30. *Senate Hearing*, *supra* note 2, at 2, 74 (Senator Burdick); *House Report*, *supra* note 4, at 6255. The chairman of the Senate Judiciary Committee described the "duty to sit" rule as a rule that clouded a judge's judgment on disqualification. *Senate Hearing*, *supra* note 2, at 74 (Senator Burdick). The House, however, added the caution that elimination of this rule "should not be used by judges to avoid sitting on difficult or controversial cases." *House Report*, *supra* note 4, at 6355; *see also* New York City Hous. Dev. Corp. v. Hart, 796 F.2d 976, 980 (7th Cir. 1986) (judge disqualified himself unnecessarily when his holdings did not constitute § 455(b)(4) financial interest). The court stated: "A judge may decide close calls in favor of recusal. But there must first be a close call." *Id.*

31. *See supra* note 12 for the text of § 455(b)(1); *see infra* note 35 for the text of § 144.

32. Courts have determined that a motion for disqualification under one of the sections—455(a), 455(b)(1), or 144—requires the consideration of disqualification under the other sections as well. *See* Roberts v. Bailar, 625 F.2d 125, 128 (6th Cir. 1980) (judge has duty to consider disqualification under § 455 when § 144 affidavit does not require disqualification); United States v. Sibla, 624 F.2d 864, 868 (9th Cir. 1980) (judge who declines to grant recusal under § 455 must still consider sufficiency of affidavit under § 144).

Courts have coordinated the statutes procedurally by charting various paths that reach, if necessary, all three provisions. One approach is to begin by evaluating the affidavit under § 144 and to proceed to assessment of the situation under § 455 only if the affidavit is untimely or insufficient. *See* United States v. Balistrieri, 779 F.2d 1191, 1202 (7th Cir. 1985) (after determining § 144 affidavit legally insufficient, court considered disqualification under § 455(b)(1)), *cert. denied*, 106 S. Ct. 3284 (1986); *Bailar*, 625 F.2d at 128 (judge disqualified under § 455(a) although § 144 affidavit was technically insufficient); *Sibla*, 624 F.2d at 868 (finding that § 144 affidavit is legally insufficient triggers duty to evaluate circumstances under § 455).

Alternatively, judges may begin with § 455(a) and evaluate the § 144 affidavit only if they do not disqualify themselves under § 455. *See Sibla*, 624 F.2d at 868 (judge who declines to grant recusal under § 455 must still consider the sufficiency of the affidavit under § 144). A judge beginning at § 455(a) would need to consider § 144 only if the allegations of bias where false and thus would not lead a reasonable person to question the judge's impartiality.

FOIA # 57720 (URTS 16326) Doc: 70105318 Page 374

statute.[33]

Section 144, first enacted in 1911,[34] focuses exclusively on bias and prejudice as grounds for disqualification.[35] It authorizes a litigant with the power to disqualify a district court judge by means of a "timely and sufficient affidavit" alleging "personal bias or prejudice" for or against a party.[36] The key to disqualification under section 144 is the sufficiency of the affidavit. As long as procedural rules regarding the form and timing of the affidavit are met,[37] the filing of a legally sufficient affidavit compels a judge to transfer the case to another district court judge.[38]

As the Supreme Court determined in *Berger v. United States*,[39] the challenged judge must take the initial step of evaluating the sufficiency of the affidavit, and may not automatically transfer the case when an affidavit is filed.[40] Thus, section 144 does not provide for peremptory challenge of the judge.[41] Instead, a judge is required to evaluate the legal sufficiency, but not the truth, of

33. *See infra* notes 112-18 and accompanying text for a discussion of courts' application of the § 144 judicial gloss to § 455(a).

34. Act of March 3, 1911, ch. 231, § 21, 36 Stat. 1090 (amended by Act of June 25, 1948, ch. 646, § 144, 62 Stat. 898) (amendment added the words "timely and sufficient" to modify "affidavit").

35. 28 U.S.C. § 144 (1982) provides:

> Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding.
>
> The affidavit shall state the facts and the reasons for the belief that bias or prejudice exists, and shall be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, or good cause shall be shown for failure to file it within such time. A party may file only one such affidavit in any case. It shall be accompanied by a certificate of counsel of record stating that it is made in good faith.

36. *Id.*

37. A § 144 affidavit must "state the facts and reasons for the belief that bias or prejudice exists," 28 U.S.C. § 144, and must be signed. *See* Roberts v. Bailar, 625 F.2d 125, 128 (6th Cir. 1980) (court need not consider § 144 motion where party had not signed affidavit). A court may consider only one affidavit filed pursuant to § 144. *See* United States v. Merkt, 794 F.2d 950, 961 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1603 (1987); United States v. Balistrieri, 779 F.2d 1191, 1199 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 3284 (1986).

Section 144's timeliness provision has been interpreted to require filing of the motion within a reasonable time of discovery of the bias. *See* United States v. Gigax, 605 F.2d 507, 511 (10th Cir. 1979) (file § 144 motion promptly after facts become known); Smith v. Danyo, 585 F.2d 83, 86 (3d Cir. 1978) (timeliness measured not in absolute and arbitrary way from date of discovery but with consideration of future stages of case).

38. *See* Berger v. United States, 255 U.S. 22, 36 (1921).

39. 255 U.S. 22 (1921).

40. *Id.* at 35-36.

41. Until the Supreme Court decided *Berger*, it was possible to interpret § 144 as providing a peremptory challenge. The chief sponsor of the bill indicated that it would function as a form of peremptory challenge of judges, 46 Cong. Rec. 2627 (1911) (statements of Rep. Cullop), and the wording of the original provision would have permitted it to be so used. Prior to amendment in 1948, the word "sufficient" did not appear as a modifier of "affidavit." Act of March 3, 1911, ch. 231, § 21, 36 Stat. 1090. The 1911 version required the judge to transfer the case when an affidavit was filed. *Id.*

the allegations.[42] Standards for determining legal sufficiency have developed in case law, interpretating the meaning of "personal" bias or prejudice.[43]

Section 455(b)(1) echoes the personal prejudice language of section 144, disqualifying where a judge "has a personal bias or prejudice" concerning a party.[44] The vagueness of language in this provision contrasts sharply with the other sections of 455(b), in which Congress spelled out in detail the amount and type of financial interest, and the degree of relationship to a participant or prior involvement in a case that necessitates disqualification.[45] Section 455(b)(1) uses undefined terms and provides no concrete guidelines for determining bias or prejudice.[46] This vagueness reflects the difficulties inherent in providing standards for disqualification on grounds of bias or prejudice. Such standards are hard to state; when concrete phrases are substituted for a vague statement of objectives, they are subject to the criticism of being underinclusive.[47]

Both Congress and the American Bar Association ("ABA") encountered this difficulty in their attempts to frame the bias and prejudice provisions of their respective codes. One of the earlier drafts of the Senate bill required disqualification when a judge "has a fixed belief concerning the merits of the matter in controversy or personal knowledge of material facts."[48] This language was later replaced with the language of section 455(b)(1), requiring disqualification where a judge "has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceedings."[49] The change followed the alterations made in the ABA Code of Judicial Conduct. The "fixed belief" language in the first ABA draft was abandoned in response to criticism that it would predispose judges to disqualification for having an understanding of the law and a commitment to uphold it.[50] The final draft of the Senate bill, like the final ABA draft, returned to the "personal bias or prejudice" language

42. *Berger*, 255 U.S. at 36. The Court explained: "To commit to the judge a decision on the truth of the facts gives chance for the evil against which the section is directed." *Id.*

43. *See infra* notes 109-94 for a discussion of judicial rules for disqualification on the basis of personal bias or prejudice.

44. 28 U.S.C. § 455(b)(1).

45. *Compare* § 455(b)(2)-(5) *with* § 455(b)(1).

46. *See supra* note 12 for the text of § 455(b)(1).

47. Courts seldom offer a definition of bias or prejudice. The Supreme Court provided a general, but tautological, definition of bias or prejudice in Berger v. United States, describing it as "a bent of mind that may prevent or impede impartiality of judgment." 255 U.S. at 33-34. In case law, positive definitions tend to be fact-specific. For example, in Mims v. Shapp, 541 F.2d 415 (3d Cir. 1976), a prisoners' rights suit in which the judge was accused of bias toward state prisoners, the court defined personal bias "as an attitude toward petitioner that is significantly different from and more particularized than the normal, general feelings of society at large against convicted wrongdoers." *Id.* at 417.

48. S. 1553, 92d Cong., 1st Sess. (1971), *reproduced in Senate Hearing*, *supra* note 2, at 3.

49. 28 U.S.C. § 455(b)(1).

50. *Senate Hearing*, *supra* note 2, at 85. As the chairman of the ABA committee explained, "There are many things on which it may be good for judges to have fixed opinions, like fixed opinions on freedom under the first amendment, fixed opinions that racial discrimination is invidious, and so on." *Id.*

FOIA # 57720 (URTS 16326) Doc: 70105318 Page 375

of section 144,[51] and thus premitted courts to apply the judicial gloss built up over the years on section 144 to section 455.[52]

II. Applying the Disqualification Statutes

Application of section 455(a),[53] the general federal disqualification statute, has been shaped in part by courts' concern to balance the advantages of disqualification with countervailing judicial interests.[54] On the one hand, disqualification of judges whenever reasonable doubt arises concerning their impartiality promotes public confidence in the judiciary. Conversely, disqualification may diminish the efficiency of the judicial system.[55] Transferring a case always creates some administrative costs, and when disqualification occurs in a complex case some time after the case has commenced in the court, the burden may be substantial.[56] Although courts may be tempted to give significant weight to efficiency, Congress' elimination of the duty to sit rule indicates that the goal of impartiality should be paramount whenever there are reasonable grounds for disqualification.[57] Congress and the courts also face the concern that litigants will manipulate disqualification to their advantage or to the disadvantage of their opponents by judge-shopping or by causing costly delays.[58]

51. *See supra* note 35 for the text of § 144. The ABA commentator indicated that despite the change in language, "[i]t was intended that a judge disqualify himself if he had made up his mind on the merits before he heard the case." *Senate Hearing*, *supra* note 2, at 93 (Professor Thode).

52. *See infra* notes 12-18 and accompanying text for a discussion of the judicial gloss on disqualification for bias or prejudice.

53. 28 U.S.C. § 455(a) (1982).

54. *See* Redish & Marshall, *supra* note 1, at 472-75 (analysis and critique of balancing test applied to procedural due process rights).

55. *See* Bloom, *Judicial Bias and Financial Interest as Grounds for Disqualification of Federal Judges*, 35 Case W. Res. L. Rev. 662, 664-65 (1985) (excessive disqualification would damage efficient administration of justice).

56. *See In re* Cement Antitrust Litig., 688 F.2d 1297, 1313 (9th Cir.) (judge disqualified in complex class action suit because his wife had minimal stock holdings in plaintiff companies), *aff'd mem. sub nom.*, Arizona v. United States Dist. Ct., 459 U.S. 1191 (1982). This case has attracted critical comment as an example of the high burden imposed by the expansive definition of financial interest in § 455(b)(4) and the impossibility of waiver under § 455(e) for § 455(b) cases. *See* Bloom, *supra* note 55, at 702-05 (disqualification for de minimis financial interest without possibility of waiver disrupts litigation and wastes judicial resources); Note, *Bias and Interest: Should They Lead to Dissimilar Results in Judicial Qualification Practice?*, 27 Ariz. L. Rev. 171, 189-92 (1985) (per se disqualification for minimal financial interests harmful to public perception of judiciary).

57. Statements from both the Senate and the House of Representatives suggested that Congress found that the large numbers of federal judges permitted liberal standards for disqualification and sharp restrictions on waiver of disqualification. *Senate Hearing*, *supra* note 2, at 74; *House Report*, *supra* note 4, at 6357. *See supra* note 30 and accompanying text for a discussion of congressional elimination of the duty to sit.

58. Concern for judge-shopping is evident in the *House Report* which stated: "Nothing in this proposed legislation should be read to warrant the transformation of a litigant's fear that a judge may decide a question against him into a 'reasonable fear' that the judge will not be impartial. Litigants ought not have to face a judge where there is a reasonable question of impartiality, but they are not entitled to judges of their own choice." *House Report*, *supra* note 4, at 6355. *See also In re* International Business Machs. Corp., 618 F.2d 923, 929 (2d Cir. 1980) (adverse ruling cannot disqualify judge).

Courts have had the opportunity to shape disqualification standards under section 455(a) through their interpretation of the law in two areas of inquiry. One question facing the courts concerns what constitutes reasonable grounds for disqualification. The substantive requirements for disqualification which have been developed through this inquiry will be discussed in section B below.[59] Another question facing the courts is whether, and to what extent, the appearance of bias justifies disqualification. Is it appropriate to disqualify a judge on the appearance of bias or is it, at least in some cases, necessary to establish bias in fact? The interpretations offered in each of these areas determine the reach of federal disqualification, its availability in particular cases, and the appealability of the denial of disqualification.

A. Assessing Bias: Standards of Proof

The question whether disqualification should rest on the appearance or the fact of bias arises because the two objectives of disqualification law—promoting confidence in the judiciary and providing a fair trial to litigants—differ in focus. Protection of individual rights requires disqualification of judges who will not consider particular cases with impartiality. Protecting and promoting public confidence in the judiciary, in contrast, depends not only on actual fairness in particular cases but also on the appearance of fairness.[60] Disqualification based on the appearance of bias may be required to promote public confidence when, in fact, no actual partiality exists.[61]

In many circumstances where federal law requires disqualification, concerns for judicial appearance and individual fairness are both present. But some circumstances may involve only one of these objectives. On the one hand, fairness may require disqualification in situations where there is no appearance of partiality and the need for disqualification is not known to anyone but the judge.[62] Public appearances, on the other hand, may require assigning another judge even in cases where litigants are confident they would be treated fairly by the disqualified judge.[63]

59. *See supra* notes 109-94 and accompanying text for a discussion of the judicial development of substantive grounds for disqualification under § 455(a).

60. *See* Note, *Disqualification of Judges and Justices in the Federal Courts*, 86 Harv. L. Rev. 736, 746-47 (1973) (concern for appearances necessary because judicial authority rests ultimately on public acceptance of judicial decisionmaking).

61. *See* Hall v. Small Business Admin., 695 F.2d 175, 178-79 (5th Cir. 1983) (to satisfy appearance of impartiality test of § 455(a), disqualification must be based on reasonable conclusion from objectively ascertainable facts, not on subjective assessment of judge's state of mind).

62. The language of 28 U.S.C. § 455 (1982), which gives judges the responsibility to disqualify themselves in several specified circumstances, provides for disqualification where no one but the judge knows the reason. Disqualification of this sort is generally not documented by written opinion. An instance of this use of § 455 may be seen in United States v. Merkt, 794 F.2d 950, 960 (5th Cir. 1986) (judge's unexplained voluntary recusal in prior case involving defendant is not sufficient grounds for disqualification in subsequent case involving defendant), *cert. denied*, 107 S. Ct. 1603 (1987).

63. *See supra* notes 21-22 and accompanying text for a discussion of waiver requirements in § 455(e), prohibiting waiver where disqualification is based on § 455(b).

FOIA # 57720 (URTS 16326) Doc 70105318 Page 376

Analysis of the language of the disqualification statutes suggests that both 28 U.S.C. §§ 144 and 455(b)(1) can be interpreted as requiring bias in fact.[64] Section 144 requires that the affidavit state facts sufficient to establish bias.[65] Section 455(b)(1) states that a judge "shall . . . disqualify himself . . . [w]here he *has* a personal bias or prejudice. . . ."[66] The same objective standard applied to these statutes is also applied to section 455(a),[67] however, and thus bias in fact cannot be established by subjective assessment of the judge's state of mind. Instead, courts have required that a litigant seeking disqualification meet a higher standard of proof to show bias in fact.[68]

A higher standard of proof is firmly established as part of the disqualification process under section 144. When scrutinizing the affidavit to determine whether it is legally sufficient,[69] courts apply a "clear and convincing" standard, and evaluate whether the facts "would *convince* a reasonable man that bias exists."[70] In contrast, courts have not asked whether the facts would cause a reasonable person to *question* the judge's impartiality under section 144.[71] Imposing a stricter standard of proof for disqualification under section 144 provides a reasonable counterbalance to the stipulation that the judge accept all the averments in a section 144 affidavit as true.[72] This more rigorous standard of proof does not, however, ensure that judges are disqualified under section 144 only where there is bias in fact. The requirement that the facts be taken as true,

64. 28 U.S.C. §§ 144, 455(b)(1) (1982). *See supra* note 12 for the text of § 455(b)(1); *see supra* note 35 for the text of § 144.

65. 28 U.S.C. § 144.

66. *Id.* § 455(b)(1) (emphasis added).

67. For the standard applied to § 144, *see* Chitimacha Tribe v. Harry L. Laws Co., 690 F.2d 1157, 1165 (5th Cir. 1982) (§ 144 affidavit sufficient if it alleges facts which, if true, would convince reasonable person that bias exists), *cert. denied*, 464 U.S. 814 (1983); *see also* United States v. Balistrieri, 779 F.2d 1191, 1199 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 3284 (1986); United States v. Thompson, 483 F.2d 527, 528 (3d Cir. 1973).

Courts tend to treat § 455 as a unit when setting forth the standard, rather than treating § 455(b)(1) separately from § 455(a). *See Story*, 716 F.2d at 1091 (reasonable person standard applied to § 455 as a whole); *Chitimacha*, 690 F.2d at 1167 (charges of partiality based on §§ 455(a) and (b) resolved by application of reasonable person standard).

68. *See Chitimacha*, 690 F.2d at 1165 (§ 144 affidavit must convince a reasonable person); *Balistrieri*, 779 F.2d at 1202 (requirement that facts convince a reasonable person of bias applied to both § 455(b)(1) and § 144).

69. Courts generally apply a three-part test for legal sufficiency, requiring that the facts set forth in the affidavit (1) be material and stated with particularity; (2) be such that, if true, they would convince a reasonable person that bias exists; and (3) show personal rather than judicial bias. United States v. Merkt, 794 F.2d 950, 960 n.9 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1603 (1987); *see also* Phillips v. Joint Legislative Comm'n., 637 F.2d 1014, 1019 (5th Cir. 1981), *cert. denied*, 456 U.S. 960 (1982); *Thompson*, 483 F.2d at 528.

70. *Thompson*, 483 F.2d at 528 (emphasis added); *accord Balistrieri*, 779 F.2d at 1199; United States v. Serrano, 607 F.2d 1145, 1150 (5th Cir. 1979), *cert. denied*, 446 U.S. 910 (1980). The standard has become more rigorous over the years. In Berger v. United States, the Supreme Court demanded only that the affidavit "give fair support to the charge of a bent of mind that may prevent or impede impartiality of judgment." 255 U.S. at 33-34.

71. *See infra* note 83 and accompanying text for discussion of the § 455(a) standard.

72. *Berger*, 255 U.S. at 36.

even where the judge knows them to be false,[73] delimits the court's assessment of the facts, making it inaccurate to describe section 144 as a statute that disqualifies only for actual bias.

Whether the "clear and convincing" standard of proof should be applied to section 455(b)(1) has seldom been addressed by the courts. Most courts treat section 455(a) as predominant, rest their decision on that section when bias or prejudice is alleged, and avoid the issue of whether they are required to make a finding of actual bias under section 455(b)(1).[74] Other courts interpret section 455(b)(1) as providing a specific example of grounds for disqualification under section 455(a) and apply to section 455(b)(1) the standard they apply to section 455(a).[75] In *United States v. Balistrieri*,[76] the United States Court of Appeals for the Seventh Circuit held that section 455(b)(1) requires that actual bias be found in order to meet that section's standard of proof.[77] The court applied the "clear and convincing" standard, asking whether a reasonable person with knowledge of all the facts would be convinced that the judge was biased.[78]

73. *Balistrieri*, 779 F.2d at 1199 (judge must assume facts are true, even if judge knows them to be false); Mims v. Shapp, 541 F.2d 415, 417 (3d Cir. 1976) (judge must accept truth of allegations and good faith of pleader even if judge has knowledge to the contrary).

74. *See, e.g., In re* Yagman, 796 F.2d 1165, 1181-82 (9th Cir. 1986) (§ 455 treated as unit in setting forth reasonable doubt standard for disqualification); United States v. Story, 716 F.2d 1088, 1091 (6th Cir. 1983) (single reasonable doubt standard established for § 455).

Focus on § 455 is not surprising. Judges can save face by disqualifying themselves under § 455(a), on grounds that a reasonable person could question their impartiality, rather than admitting they are actually biased by disqualifying themselves under § 455(b)(1). *See Balistrieri*, 779 F.2d at 1203 (judges may be especially reluctant to recuse themselves when doing so requires admission that actual bias or prejudice has been proved). Likewise, it is logical for one to surmise that courts of appeals support that focus, because they may then avoid directly impugning the integrity of district court judges by using § 455(a) instead of § 455(b)(1).

75. *See, e.g.*, United States v. Sibla, 624 F.2d 864, 867 (9th Cir. 1980) (§ 455(b)(1) simply provides specific example of situation in which a judge's "impartiality might reasonably be questioned" pursuant to § 455(a)); United States v. Conforte, 624 F.2d 869, 881 (9th Cir.) (same test for subsections (a) and (b) which disqualifies on a reasonable person standard for either the appearance or the fact of bias) *cert. denied*, 449 U.S. 1012 (1980).

Bloom, *supra* note 55, at 675, suggests that the Ninth Circuit Court of Appeals applies the bias in fact requirement of § 455(b)(1) to both § 455(a) and § 455(b)(1). But the court made clear in *Conforte* that both sections would be evaluated under the standard requiring disqualification for the appearance of bias set forth in § 455(a). 624 F.2d at 881.

The Fifth Circuit Court of Appeals, soon after § 455 was revised, issued an ambiguous holding that could be interpreted as imposing a bias in fact requirement on both § 455(a) and § 455(b)(1). Parrish v. Board of Comm'rs, 524 F.2d 98, 103-04 (5th Cir. 1975) (en banc), *cert. denied*, 425 U.S. 944 (1976). *See* Comment, *Disqualification of Federal Judges for Bias or Prejudice*, 46 U. CHI. L. REV. 236, 248 n.66 (1978) (*Parrish* holding ambiguous but compatible with appearance of bias rule). *But cf.* Bloom, *supra* note 55, at 675 (*Parrish* and subsequent cases require bias in fact). More recent Fifth Circuit decisions clearly apply the § 455(a) requirements to both § 455(a) and § 455(b)(1). *See* United States v. Merkt, 794 F.2d 950, 960 n.8 (5th Cir. 1986) (test of whether reasonable person would "harbor doubts" applied to both sections), *cert. denied*, 107 S. Ct. 1603 (1987).

76. 779 F.2d 1191 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 1490 (1986).

77. *Id.* at 1202. The *Balistrieri* court apparently based its holding on a literal reading of the statute. The court stated that actual bias was required after simply reciting the statutory language and offered no other support for this position. *Id.*

78. *Id.* at 1202. The court reasoned that "[t]he disqualification of a judge for actual bias or

FOIA # 57720 (URTS 16326) Do[illegible]:70105318 Page 377

The language of section 455(a) suggests that it requires disqualification for the appearance of bias.[79] The section mandates disqualification when a reasonable person would question a judge's impartiality, regardless whether actual bias exists.[80] Clear and convincing evidence is not required by the language of the statute.[81] Moreover, disqualification when doubt about impartiality exists, rather than only when convincing evidence of bias is produced, is in keeping with the congressional aim to eliminate the duty to sit rule and replace it with the rule that judges, when uncertain, should disqualify themselves.[82]

Courts generally apply the reasonable doubt standard to section 455(a) disqualification and disqualify for the appearance of bias.[83] However, the standard of proof for disqualification under section 455(a) was subject to controversy for a time during which some courts of appeals' decisions were interpreted as equating section 455(a) with section 144 and requiring the same "clear and convincing" standard of proof.[84] This position appears to have been abandoned.[85]

Recently, however, a new controversy has arisen. The Seventh Circuit has limited appellate review of disqualification under section 455(a) because that section disqualifies based on the appearance of bias or prejudice.[86] After requiring

prejudice is a serious matter, and it should be required only when the bias or prejudice is proved by compelling evidence." *Id.* The court found no actual bias on the part of the judge who had previously worked as a prosecutor and allegedly targeted the defendant as the head of an organized crime family. *Id.* at 1196-97.

79. *See supra* note 12 for the text of § 455(a).

80. Hall v. Small Business Admin., 695 F.2d 175, 178-79 (5th Cir. 1983) (test under § 455(a) is appearance of partiality, not actual prejudice); *see also* Balistrieri, 779 F.2d at 1204; United States v. Nobel, 696 F.2d 231, 235-36 (3d Cir. 1982), *cert. denied*, 462 U.S. 1118 (1983).

81. 28 U.S.C. § 455(a).

82. *Senate Hearing*, *supra* note 2, at 2, 74 (Senator Burdick); *House Report*, *supra* note 4, at 6354. *See* Roberts v. Bailar, 625 F.2d 125, 129 (6th Cir. 1980) (disqualification required even where question is close).

83. *See, e.g.*, United States v. Nobel, 696 F.2d at 235-36 (3d Cir. 1982) (§ 455(a) disqualifies on appearance of bias standard), *cert. denied*, 462 U.S. 1118 (1983); Chitimacha Tribe v. Harry L. Laws Co., 690 F.2d 1157, 1165 (5th Cir. 1982) (standard is whether reasonable person would harbor doubts about judge's impartiality; appearance of impartiality is required), *cert. denied*, 464 U.S. 814 (1983).

84. *See* Idaho v. Freeman, 507 F. Supp. 706, 723-725 (D. Idaho 1981) (Fifth and Ninth Circuits interpret § 455(a) as requiring bias in fact) (citing United States v. Olander, 584 F.2d 876, 882 (9th Cir. 1978) (§ 455(a) should be interpreted as setting up same test for disqualification as § 455(b)(1) and § 144) and Parrish v. Board of Comm'rs, 524 F.2d 98, 101-02 (5th Cir. 1975) (en banc) (gloss on § 144 applies fully to § 455), *cert. denied*, 425 U.S. 944 (1976)); *see also* Bloom, *supra* note 55, at 675 (Fifth Circuit and Ninth Circuit cases require bias in fact).

85. The Fifth Circuit, which may have required bias in fact at one time, has more recently stated clearly that the standard under § 455(a) is the appearance of bias. Hall v. Small Business Admin., 695 F.2d 175, 178-79 (5th Cir. 1983) (test under § 455(a) is appearance of partiality rather than actual bias). *See also* Comment, *supra* note 74, at 248 n.66 (majority opinion in *Parrish* ambiguous; can be read as acknowledging appearance of bias standard for § 455(a)).

The Ninth Circuit backed away from the bias in fact requirement in United States v. Conforte, 624 F.2d 869 (9th Cir. 1980). The *Conforte* court interpreted its *Olander* holding to mean that the same substantive rules regarding bias or prejudice would apply whether the court was determining the appearance or the fact of bias. *Conforte*, 624 F.2d at 880 (citing Idaho v. Freeman, 584 F.2d at 882).

86. United States v. Balistrieri, 779 F.2d 1191, 1204 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 1490 (1986). *Accord* New York City Hous. Dev. Corp. v. Hart, 796 F.2d 976, 979 (7th Cir. 1986); Union Carbide Corp. v. U.S. Cutting Serv., Inc., 782 F.2d 710, 713 (7th Cir. 1986).

proof of bias in fact under section 455(b)(1) in *Balistrieri*,[87] the Seventh Circuit refused to consider whether the judge should have recused himself from the case under section 455(a). Rather, the court held that the denial of disqualification under section 455(a) is not reviewable on post-trial appeal because disqualification under that section does not rest on actual bias.[88] The court reasoned that because the standard in section 455(a) is the appearance of bias, in contrast to the actual bias standard of section 455(b), section 455(a) does not implicate the substantive rights of the parties.[89] The court characterized section 455(a) as aimed only at protecting against injury to the judicial system as a whole, and further suggested that a pretrial mandamus petition provides the only appropriate vehicle for review.[90]

This distinction could severely limit the number of disqualification denials that could be heard on appeal. Courts tend to focus on section 455(a) when considering disqualification and thus may not develop a record that will permit full consideration of whether disqualification could be supported by clear and convincing evidence.[91] In addition, questions regarding the impartiality of judges do not only arise before trial, but instead may come to the attention of a party during or after trial.[92]

More fundamentally, the legislative history of section 455 does not support a bifurcation of the focus and reviewability of its subsections. Section 455(a) is not accurately characterized as directed solely toward appearances and thus does not compel the *Balestrieri* court's interpretation. Advocates of section 455(a) described it as a provision that would enhance public confidence,[93] but it was not proposed exclusively for that purpose. Instead, members of Congress and the ABA Judicial Conduct Committee viewed section 455(a) as a provision that would fill in gaps and provide a requirement for disqualification in circumstances not covered by the specific standards set forth in section 455(b).[94] The Senate committee, for example, regarded section 455(a) as a tool for disqualifying a judge for a close personal relationship not covered by section 455(b)(5), which requires disqualification in cases involving relatives up to the third degree of blood relationship.[95] The chairman of the ABA committee also regarded the general provision as a means for disqualifying judges for actual bias, and noted

87. *See supra* notes 76-78 and accompanying text for a discussion of the *Balistrieri* court's analysis of § 455(b)(1).

88. 779 F.2d at 1204.

89. *Id.*

90. *Id.* at 1204-05.

91. *See supra* notes 73-74 and accompanying text for a discussion of the courts' tendency to focus on § 455(a).

92. *See, e.g.*, Southern Pacific Communications Co. v. American Tel. & Tel. Co., 740 F.2d 980, 983 (D.C. Cir. 1984) (disqualification issue arose as a result of opinions expressed in judge's memorandum opinion), *cert. denied*, 470 U.S. 1005 (1985).

93. *House Report*, *supra* note 4, at 6355.

94. *Id.*

95. *Senate Hearing*, *supra* note 2, at 112 (statements of Prof. Thode and Mr. Westphal).

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Case 1:04-cv-07720-ORK Document 70105-18 Page 378

that there was no need for "fixed opinion" language in section 455(b)(3) because a judge who had expressed an opinion on the merits of a controversy would be disqualified under 455(a).[96] These examples indicate that section 455(a) was directed toward actual bias as well as toward the appearance of bias.

Section 455(b) also serves this dual function. Some of the provisions in section 455(b) are clearly directed at promoting the appearance of impartiality rather than protecting parties from actual bias. For example, under section 455(b) a judge is disqualified if she has any financial interest in the case, no matter how small, without the possibility of waiver.[97] Concerns with both due process and the preservation of confidence in the judicial system thus permeate the entirety of section 455.

The Supreme Court's analysis of the due process right to an impartial judge provides yet another reason for rejecting an interpretation of the disqualification statutes that conditions review on a finding of actual bias. The due process criteria for judicial disqualification, as delineated by the Supreme Court,[98] is not as extensive as the federal statutory requirements mandating disqualification. The Court has focused on disqualification for interest,[99] leaving open the question whether a bias charge implicates due process.[100] Yet the Court has indicated that where due process requires disqualification, it is concerned with the appearance of justice.

96. *Id.* at 87-88. Judge Traynor, chairman of the ABA Special Committee of Standards of Judicial Conduct, objected to what is now § 455(b)(3), and argued that the last part of that provisions, not found in the ABA Code, was unnecessary. *Id.*

97. *See supra* note 12 for text of §§ 455(b)(4) and 455(d)(4). *But see* Note, *supra* note 56, at 189-92 (per se disqualification for minimal financial interests harmful to public perception of judiciary).

98. *See infra* notes 99-107 and accompanying text for a discussion of Supreme Court cases setting forth the due process standards.

99. *See, e.g.*, Ward v. Village of Monroeville, 409 U.S. 57, 60-61 (1972) (due process right violated where judge is mayor of town receiving benefit of fines); *In re* Murchison, 349 U.S. 133, 136-37 (1955) (due process right violated where trial judge also acted as prosecuting judge); Tumey v. Ohio, 273 U.S. 510, 523 (1927) (due process right violated where judge's salary paid in part by fines judge imposed).

100. *See, e.g.*, Aetna Life Ins. Co. v. Lavoie, 106 S. Ct. 1580, 1585 (1986) (only in extreme cases would disqualification on basis of personal bias or prejudice be constitutionally required); *Tumey*, 273 U.S. at 523 (not all questions of judicial disqualification are constitutional questions). These cases involved disqualification of state court judges.

Other due process decisions dealing with adjudicative impartiality have involved administrative decisionmakers. *See* Marshall v. Jerrico, Inc., 446 U.S. 238, 242-43 (1980) (decision by regional administrator in Department of Labor not required to meet impartiality standards applied to judges); FTC v. Cement Inst., 333 U.S. 683, 701-02 (1948) (FTC's expressed opinions on points of law neither evidence of bias nor violative of due process).

In the few federal judicial disqualification cases heard by the Supreme Court, the Court has not reached the question of due process but rather has confined itself to interpreting the federal statute at issue. *See* United States v. Grinnell Corp., 384 U.S. 563, 580-83 (1966) (applying § 144 where judge's personal bias alleged); Berger v. United States, 255 U.S. 22, 34-35, (1921) (applying Act of March 3, 1911, ch. 231, § 21, 36 Stat. 1090, precusor to § 144). The Court's focus on statutory interpretation is consistent with its practice of resolving cases on statutory grounds if possible before reaching constitutional questions. *See* Wood v. Strickland, 420 U.S. 308, 314 (1975) (Court practice is to deal with dispositive statutory issues before considering constitutional questions).

The Court's recent decision in *Aetna Life Insurance Co. v. Lavoie*[101] illustrates its approach to the due process implications of judicial bias. In *Lavoie*, an insurance company charged that its due process rights were violated because the chief judge on the state appellate court panel was suing other insurance companies on issues similar to those in the *Lavoie* case and because the other judges on the panel were class plaintiffs in one of the suits.[102] The Court found that due process required disqualification of the chief judge on the basis of interest because his decision in *Lavoie* could enhance the status of a case he had filed in a lower court.[103]

The Supreme Court declined to find due process violations based on other grounds of personal bias and interest alleged by the appellants.[104] Noting that the right to due process does not extend so far as to require disqualification under the fourteenth amendment whenever it is required under statute, the Court held that "only in the most extreme of cases would disqualification . . . be constitutionally required" on the basis of bias or prejudice.[105] The Court also held that the Constitution does not require disqualification for only a slight pecuniary interest.[106]

Although the *Lavoie* Court held that the due process right to disqualification does not extend to all the circumstances in which Congress has required disqualification, the Court did not tie due process disqualification to a showing of actual fairness. Instead, the Court reiterated the position that due process requires disqualification on the basis of the appearance of partiality, stating:

> We made clear that we are not required to decide whether in fact Justice Emery was influenced, but only whether sitting on the case . . . "would offer a possible temptation . . . to the average [judge] . . . [to] lead him not to hold the balance nice, clear, and true." The Due Process Clause "may sometimes bar trial judges who have no actual bias and who would do their very best to weigh the scales of justice equally between contending parties. But to perform its high function in the best way, 'justice must satisfy the appearance of justice.' "[107]

Thus, the Supreme Court established that whether the due process right to an

101. 106 S. Ct. 1580 (1986).

102. *Id.* at 1582-83.

103. *Id.* at 1586-87.

104. *Id.* at 1585, 1588.

105. *Id.* at 1585. The Court determined that the appellant's allegation of bias based on the chief judge's expressions of general frustration with insurance companies did not rise to the level of a constitutional question. *Id.* The Court did not, however, indicate what circumstances or what evidence of bias would rise to the level of a due process violation.

For a critique of the judicial reluctance to find violations of due process where bias or prejudice is alleged, *see* Redish & Marshall, *supra* note 1, at 500-02 (distinction in constitutional treatment between personal bias and interest unjustified).

106. *Lavoie*, 106 S. Ct. at 1587-88. The Court ruled that the alleged interest of the other judges on the panel, who were members of the plaintiff class in a suit against another insurance company, was "highly speculative and contingent," and thus did not meet the due process test that an interest be direct, personal, substantial, and pecuniary. *Id.* at 1588.

107. *Id.* at 1587 (quoting Ward v. Village of Monroeville, 409 U.S. 57, 60-61 (1972) and *In re* Murchison, 349 U.S. 133, 136 (1955) respectively).

FOIA # 57720 (URTS 16320) Doc. 70105318 Page 379

impartial judge requires disqualification depends on reasonable inferences from facts that raise the possibility of bias, and not a finding of actual bias.

In instituting the objective standard, Congress made a similar choice regarding the extent of inquiry into bias. Investigation into the state of mind of a judge under the objective standard stops at the point where a reasonable inference of bias or prejudice can be made. This limitation of the inquiry permits, and indeed requires, higher courts to consider disqualification without establishing whether a party actually suffered a violation of the right to an independent adjudicator. Thus the restrictions on the appeal of section 455(a) imposed by the Seventh Circuit,[108] a court which refuses post-trial review unless actual bias is involved, are not justified.

B. Reasonable Grounds for Disqualification

1. Judicially-Created Requirements for Disqualification for Bias or Prejudice

The most significant way in which courts have limited the availability of disqualification is by placing restrictions on the types of evidence that can be considered in support of disqualification. Courts require that evidence of bias or prejudice have an extrajudicial source and refuse to consider disqualification for opinions on the law.[109] Some courts, however, have interpreted the requirement of "personal" bias to preclude disqualification on grounds of bias toward an attorney.[110] The requirement of "personal" prejudice is also used to refuse disqualification on the basis of general background and experience.[111]

These restrictions originally developed through courts' interpretations of 28 U.S.C. § 144.[112] The question whether the judicial gloss on section 144 should apply to 28 U.S.C. § 455[113] was answered in the affirmative soon after section 455 was revised. In *Davis v. Board of School Commissioners*,[114] the United States Court of Appeals for the Fifth Circuit found "no suggestion in the legislative history that [section 144] decisions were being overruled or in any way eroded."[115] The court concluded that it should "give [sections] 144 and 455 the same meaning legally . . . whether for purposes of bias and prejudice or when the impartiality of the judge might reasonably be questioned."[116] Most courts agree

108. *See supra* notes 86-90 and accompanying text for a discussion of the Seventh Circuit position concerning appellate review of disqualification decisions.

109. *See infra* notes 124-50 and accompanying text for a discussion of the extrajudicial source requirement. *See supra* notes 51-83 and accompanying text for discussion of disqualification for opinions on the law.

110. *See infra* notes 184-88 and accompanying text for a discussion of disqualification for bias toward an attorney.

111. *See supra* notes 89-94 and accompanying text for discussion of courts' refusal to disqualify on the basis of general background and experience.

112. 28 U.S.C. § 144 (1982).

113. *Id.* § 455 (1982).

114. 517 F.2d 1044 (5th Cir. 1975), *cert. denied*, 425 U.S. 944 (1976).

115. *Id.* at 1052.

116. *Id.*

that the judicial interpretation of section 144 applies fully to section 455.[117] In effect, these courts are finding that the judicial gloss on bias and prejudice defines the grounds upon which it is *reasonable* to question a judge's impartiality.[118]

Court-made restrictions developed under section 144 and carried over to disqualification under section 455 in part reflect the logic of the judicial decision-making process and promote efficiency.[119] The restrictions may, however, protect the efficiency of the system at the expense of fairness and public confidence in the judiciary. Unfortunately, the presumption that judges are impartial results in restrictions on evidence and the imposition of a heavy burden on a movant.[120] To surmount this presumption, a litigant generally must show clear evidence of personal bias.[121] Occasionally, courts have based disqualification on evidence of a level of emotional involvement that indicates "pervasive prejudice."[122] This heavy burden on the movant however, may not further the goals of disqualification law.[123]

117. *See, e.g.*, United States v. Story, 716 F.2d 1088, 1091 (6th Cir. 1983) (well settled that §§ 144 and 455 "must be construed *in pari materia*") (quoting City of Cleveland v. Kruppansky, 619 F.2d 576, 578 (6th Cir.), *cert. denied* 449 U.S. 834 (1980)); United States v. Sibla, 624 F.2d 864, 869 (9th Cir. 1980) (§§ 455(a) & (b)(1), like § 144, require recusal only if bias or prejudice is directed against party and stems from extrajudicial source); *In re* International Business Machs. Corp., 618 F.2d 923, 928-29 (2d Cir. 1980) (§§ 455(a) and 455(b)(1) require that bias be personal and from extrajudicial source).

118. *See* United States v. Haldeman, 559 F.2d 31, 132 n.297 (D.C. Cir. 1976) (judicial understanding of § 144 applies to revised § 455, which requires disqualification when impartiality may reasonably be questioned), *cert. denied*, 431 U.S. 933 (1977).

A few courts have disagreed, stating that the judicial interpretation of § 144 does not carry over to § 455(a). United States v. Coven, 662 F.2d 162, 168 (2d Cir. 1981), *cert. denied*, 456 U.S. 916 (1982). *See also* United States v. Cepeda Penes, 577 F.2d 754, 758 (1st Cir. 1978) (§ 455(a) permits disqualification on evidence from judicial source). The minority view does not, however, produce results significantly different from the results reached by courts which apply the § 144 judicial gloss to § 455(a). The courts that limit the applicability of the § 144 judicially-created rules take them as being without exception or nuance. In contrast, courts that apply the §§ 144 requirements to § 455(a) include exceptions within the standards they apply to each of the sections. *Compare Coven*, 662 F.2d at 168-69 (information from a judicial source relevant but not sufficienlty prejudicial to disqualify without any other basis in record for questioning judge's impartiality) *with* Nicodemus v. Chrysler Corp., 596 F.2d 152, 156-57 (6th Cir. 1979) (emotional response by judge within judicial context sufficiently prejudicial to warrant disqualification).

119. *See infra* notes 127-34 and accompanying text for a discussion of the advantages of the extrajudicial source requirement.

120. *See, e.g.*, United States v. Lee, 648 F.2d 667, 669 (9th Cir. 1981) (nature of judicial system is such that judges must rise above impermissible influences); United States v. Sinclair, 424 F. Supp. 715, 718 (D. Del. 1976) (affidavit must be strictly construed because judge presumed impartial), *aff'd*, 566 F.2d 1171 (3d Cir. 1977); *see also infra* notes 169-71 and accompanying text for a discussion of the presumption of impartiality in the context of disqualification for judges' opinions on the law.

121. *See infra* notes 135-40 and accompanying text for a discussion of the requirement for clear evidence of personal prejudice.

122. *See infra* notes 178-83 for a discussion of a proposal to permit disqualification based on strongly-felt disagreement with the law.

123. *See infra* notes 141-44 and accompanying text for a discussion of the pervasive prejudice exception to the extrajudicial source requirement.

FOIA # 57720 (URTS 16326) Doc: 70105318 Page 380

a. *The extrajudicial source requirement*

A fundamental principle of the judicially-created standards for disqualifying judges for bias and prejudice is that the evidence of bias must come from an extrajudicial source. Evidence of prejudice or bias that arises from or can be linked to a judicial source, such as pretrial or trial proceeding or any aspect of case management, is excluded from consideration.[124] The Supreme Court stated this requirement in *United States v. Grinnell*:[125] "The alleged bias and prejudice to be disqualifying must stem from an extrajudicial source and result in an opinion on the merits on some basis other than what the judge learned from his participation in the case."[126]

The extrajudicial source requirement is most frequently applied to reject disqualification on the basis of statements made by a judge in the course of a case.[127] Courts also apply the extrajudicial source requirement to reject disqualification based on adverse rulings by a judge,[128] whether in the trial of the party bringing the motion[129] or in previous trials.[130] In criminal trials, the extrajudicial source rule is used to prevent disqualification on the basis of allegations questioning a judge's impartiality merely because the judge, while presiding over a previous hearing, was exposed to or ruled on evidence.[131] The extrajudicial

124. *See, e.g.*, United States v. Haldeman, 559 F.2d 31, 133 (D.C. Cir. 1976) (§ 144 does not disqualify judges on basis of prior judicial rulings or in-court comments prompted by legal proceedings), *cert. denied*, 431 U.S. 933 (1977).

125. 384 U.S. 563 (1966).

126. *Id.* at 583.

127. *Id.* at 580-83 (judge's comments critical of attorney's handling of case are not grounds for disqualification). *See also* Johnson v. Trueblood, 629 F.2d 287, 291 (3d Cir. 1980) ("intemperate" statements in settlement conference based on perception of case are not grounds for disqualification), *cert. denied*, 450 U.S. 999 (1981).

128. *See Ex parte* American Steel Barrel Co., 230 U.S. 35, 44 (1913) (adverse rulings not grounds for disqualification).

129. *In re* International Business Machs. Corp., 618 F.2d 923, 927-30 (2d Cir. 1980) (statistical evidence of pattern of adverse ruling not grounds for disqualification under §§ 144 or 455).

130. *See* Phillips v. Joint Legislative Comm., 637 F.2d 1014, 1020 (5th Cir. 1981) (outmoded and improper racial remarks incorporated in prior rulings do not disqualify judge in subsequent civil rights case), *cert. denied*, 456 U.S. 960 (1982); United States v. Jackson, 627 F.2d 1198, 1207 n.20 (D.C. Cir. 1980) (prior judicial exposure to same type of case inadequate basis for showing personal bias).

131. For application of the extrajudicial source requirement to bail hearings, *see, e.g.*, United States v. Archbold-Newball, 554 F.2d 665, 681-82 (5th Cir.) (judge's bail denial based on stated belief of police testimony that defendants were in conspiracy not grounds for recusal), *cert. denied*, 434 U.S. 1000 (1977).

For application of the extrajudicial source requirement to other pretrial proceedings, *see, e.g.*, United States v. Porter, 701 F.2d 1158, 1166 (6th Cir.) (judge's comment during preliminary hearing that defendants were "apparently caught red-handed" not grounds for disqualification absent pervasive bias), *cert. denied*, 464 U.S. 1007 (1983); United States v. Cepeda Penes, 577 F.2d 754, 756-58 (1st Cir. 1978) (judge who heard aborted attempt to plead nolo contendere not disqualified from presiding over trial).

For application of the extrajudicial source requirement to trials, *see, e.g.*, Demjanjuk v. Petrovsky, 776 F.2d 571, 577 (6th Cir. 1985) (judge who presided over denaturalization hearing need not disqualify himself from extradition hearing or from considering habeas corpus relief), *cert. denied*, 106 S. Ct. 1198 (1986); *In re* Corrugated Container Antitrust Litig., 614 F.2d 958, 963-66 (5th Cir.)

source requirement is also invoked to reject disqualification based on claims of bias resulting from hostile actions of a party or an attorney toward a judge or resulting from the judge's response to such actions.[132]

The extrajudicial source requirement protects the judicial system from unreasonable interference with judicial decision-making. If statements of opinion could generally disqualify a judge, adjudicators could be inhibited from carrying out the evaluative tasks required to move cases through the court and to reach decisions.[133] Use of the extrajudicial source requirement to avoid disqualification as a result of the provocation of a party or attorney serves to prevent litigants from manipulating the judicial system to their advantage by harrassing judges.[134]

Despite the important benefits of the extrajudicial source requirement, it could stand in the way of a fair, impartial trial if it were rigidly applied. An absolute refusal to consider as evidence of bias or prejudice any statement made in a judicial setting in response to information learned in the case gives judges a zone of immunity in which to voice personal prejudices. Courts do not, however, generally invoke the extrajudicial source rule to protect a judge from disqualification who has made statements within the judicial context that present clear evidence of personal bias for, or prejudice against, an individual in the case.

(judge who presided over criminal trial not disqualified from hearing subsequent civil trial), *cert. denied*, 449 U.S. 888 (1980); United States v. Partin, 552 F.2d 621, 637 n.20 (5th Cir.) (judge not disqualified from presiding over retrial), *cert. denied*, 434 U.S. 903 (1977).

132. *See, e.g.*, United States v. Studley, 783 F.2d 934, 939-40 (9th Cir. 1986) (fact that defendant publically denounced and filed lawsuit against judge not grounds for disqualification); United States v. Phillips, 664 F.2d 971, 1000-04 (5th Cir. 1981) (no extrajudicial source of bias to disqualify judge who learned of and discussed defendant's plans to disrupt trial and his threats against judge's life), *cert. denied*, 457 U.S. 1136 (1982).

133. *See In re* International Business Machs. Corp., 618 F.2d 923 (2d Cir. 1980), in which the court stated: "A trial judge must be free to make rulings on the merits without the apprehension that if he makes a disproportionate number in favor of one litigant, he may have created the impression of bias." *Id.* at 929. *See also* Johnson v. Trueblood, 629 F.2d 287, 291 (3d Cir. 1980) (extrajudicial source rule extended to statements in settlement conference to avoid unduly hampering judge's ability to effectuate settlement), *cert. denied*, 450 U.S. 999 (1981).

The use of this rationale in Phillips v. Joint Legislative Comm., 637 F.2d 1014 (5th Cir. 1981), *cert. denied*, 456 U.S. 960 (1982), in response to allegations of racism, raises the question whether the protection afforded by the extrajudicial source requirement extends too far. The court stated:

> We would be reluctant, in any but an extreme case, to base a disqualification order on . . . allegations [of a pattern of racism in prior opinions]. It is a district judge's duty to conduct trials, weigh evidence, consider the law, exercise his discretion, and reach decisions in the cases on which he sits. If he understands that a seemingly harsh comment toward a party or an attorney, or a perceived tendency to give severe sentences to some class of offenders, or an aggregate imbalance in victories for plaintiffs or defendants in a particular class of cases may subject him to a train of successful recusal motions in future cases, he may consciously or subconsciously shape his judicial actions in ways unrelated to the merits of the cases before him.

Id. at 1020.

134. *See, e.g.*, Wilks v. Israel, 627 F.2d 32, 37 (7th Cir. 1980) (allowing defendant's assault of judge to support disqualification would encourage unruly courtroom behavior and result in disruption of judicial administration), *cert. denied*, 449 U.S. 1086 (1981).

FOIA # 57201URS 1632a Docid: 70105318 Page 381

Berger v. United States[135] presents a classic example of prejudicial statements made by a judge within the judicial context. In *Berger*, the judge allegedly delivered an anti-German diatribe in a case involving Germans and German-Americans as defendants.[136] Another example of a judicial remark revealing bias is found in *Roberts v. Bailar*,[137] a case which involved an employment discrimination suit against the Postal Service. In response to a motion to dismiss a party who had a supervisory role,[138] the district court judge said: "I know Mr. Graves, and he is an honorable man and I know that he would never intentionally discriminate against anybody."[139] Because the actions of this "honorable man" were at issue in the discrimination suit, the court of appeals held that "it is clear that a reasonable person would question the impartiality of the District Judge."[140]

The statement at issue in a disqualification motion may not, however, clearly reveal personal bias or prejudice evidenced through an extrajudicial source, but rather may suggest that a bias toward or prejudice against a party has developed over the course of the proceeding or a prior proceeding. Disqualifying a judge in these circumstances requires making an exception to the extrajudicial source rule when a judge's statement or actions reveal that he or she has not or is not likely to put aside personal feelings in conducting the trial or passing judgment. The United States Court of Appeals for the Fifth Circuit suggested the possibility of a "pervasive prejudice" exception in *Davis v. Board of School Commissioners*[141] and applied this exception in *United States v. Holland*.[142] In *Holland*, a defendant sought disqualification of a district court judge after gaining a new trial on appeal because the judge stated that the defendant had "broken faith" with the court by appealing and intended to increase the defendant's sentence.[143] The appellate court held that the district judge's statement showed pervasive prejudice and thereby satisfied the reasonable person standard for disqualification.[144]

In *Nicodemus v. Chrysler Corp.*,[145] the Sixth Circuit Court of Appeals disqualified a judge for bias on the basis of his "vilification" of the defendant in an employment discrimination suit.[146] The court indicated that the development of some degree of bias over the course of court proceedings is a normal part of the judicial process,[147] but declared that " 'if . . . a judge's bias appears to have become overpowering, we think it disqualifies him.' "[148]

In a situation in which the judge was directly or deliberately provoked by a participant in the case, an emotional response by a judge generally will not disqualify her.[149] Nevertheless, even in circumstances in which the judge has been deliberately provoked, an extreme reaction to a party or attorney may necessitate disqualification.[150] The appropriate focus under section 455(a) is not whether the judge's statement springs from an extrajudicial source but instead whether the judge's statement or action would lead a reasonable person to question whether the judge would remain impartial.

b. *Opinion on law or policy*

A second fundamental principle of disqualification law articulated by the courts is that judges cannot be disqualified for their knowledge of, or opinions on, the legal issues in a case.[151] The policy concerns underlying this rule are

135. 255 U.S. 22 (1921).

136. *Id.* at 28-29. *See also* Connelly v. United States Dist. Ct., 191 F.2d 692, 694-95 (9th Cir. 1951) (judge disqualified who publicly stated that Communists hid behind Bill of Rights and who said to counsel, "I'm sorry to see you get mixed up with these Commies.").

137. 625 F.2d 125 (6th Cir. 1980).

138. The party was the local postmaster for whom the Postmaster General was substituted. *Id.* at 127.

139. *Id.* at 127.

140. *Id.* at 129.

141. 517 F.2d 1044, 1051 (5th Cir. 1975), *cert. denied*, 425 U.S. 944 (1976).

142. 655 F.2d 44 (5th Cir. 1981).

143. *Id.* at 45 & n.2.

144. *Id.* at 47.

145. 596 F.2d 152 (6th Cir. 1979).

146. *Id.* at 157. The district judge stated:

> This thing is the most transparent and the most blatant attempt to intimidate witnesses and parties that I have seen in a long time. I don't believe anything that anybody from Chrysler tells me because there is nothing in the record that is before me and in my experience in dealing with this case that gives me reason to believe that they are worthy of credence by anybody. They are a bunch of villains and they are interested only in feathering their own nests at the expense of everybody they can, including their own employees, and I don't intend to put up with it.

Id. At a later point in the trial, the judge indicated that the award he granted was shaped by his negative assessment of the defendant. *Id.* at 156-57.

In Shank v. American Motors Corp., 575 F. Supp. 125 (E.D. Pa. 1983), a district court judge reacted in similar fashion to the defendant automobile manufacturers. The judge refused to disqualify himself, alleging that his statement arose out of judicial experience and did not indicate extrajudicial bias. *Id.* at 129. He said, "Automobile manufacturers are among the most devious groups of defendants that I have seen in twenty-one years on the Bench." *Id.* The defendants did not appeal this denial of disqualification.

147. *Id.* at 156. The court stated: " 'Often some degree of bias develops inevitably during a trial. Judges cannot be forbidden to feel sympathy or aversion for one party or the other. Mild expressions of feeling are as hard to avoid as the feeling itself.' " *Nicodemus*, 596 F.2d at 156 (quoting Whitaker v. McLean, 118 F.2d 596, 596 (D.C. Cir. 1941)).

148. *Nicodemus*, 596 F.2d at 156 (quoting Whitaker v. McLean, 118 F.2d at 596).

149. *See, e.g.*, Mayberry v. Pennsylvania, 400 U.S. 455, 463 (1971) ("A judge cannot be driven out of a case"); Wilks v. Israel, 627 F.2d 32, 37 (7th Cir. 1980) (judge not disqualified for response toward defendant who had assaulted him), *cert. denied*, 449 U.S. 1086 (1981).

150. *See Mayberry*, 400 U.S. at 465-66 (judge became "personally embroiled" with defendant, and therefore defendant given public trial before another judge). *Compare In re* Jafree, 741 F.2d 133, 136-37 (7th Cir. 1984) (in non-summary contempt proceeding for defamatory actions toward district court judges in which court did not follow proper procedure, judges disqualified for being personally embroiled in the controversy) *with* United States v. Greer, 714 F.2d 358, 360 (4th Cir. 1983) (judge who objected to attorney's accusation that he sentenced on racial basis and then called a recess, permitting time for emotions to cool, not disqualified for bias) *and Wilks*, 627 F.2d at 36-37 (although judge responded to assault, reaction did not disqualify him because he calmed down and conducted fair trial).

151. This rule is mitigated somewhat by 28 U.S.C. § 455(b)(3), which provides that judges who had been government employees are disqualified from a case if they previously served as counsel, adviser, or material witness concerning the proceedings, or if they expressed an opinion on the merits of the case. *Id.*

FOIA# 57720 (URTS 1632) Docld: 70105318 Page 382

clear: disqualification on grounds of previously developed legal opinion would wreak havoc within the judicial system. As the United States Court of Appeals for the Third Circuit recently observed: "If [j]udges could be disqualified because their background in the practice of law gave them knowledge of the legal issues which might be presented in cases coming before them, then only the least-informed and worse-prepared lawyers could be appointed to the bench."[152]

Although the judicially-created rule against considering disqualifying judges on the basis of their legal knowledge is a sound one, application of the rule may be problematic when a judge has been personally involved in instituting a particular policy or when a judge has emphatically expressed support for, or opposition to, a policy position. The best-known case involving the issue of disqualification of a judge for his involvement in instituting a policy is *Laird v. Tatum*,[153] a case in which the plaintiffs challenged army surveillance of anti-war protestors.[154] Plaintiffs moved to disqualify Justice Rehnquist, who had cast the deciding vote in a five to four decision dismissing the case,[155] on the grounds that he had been involved in defending the surveillance program before a Senate committee as assistant attorney general in the Nixon administration.[156] Justice Rehnquist determined that he was not obliged to disqualify himself because he "did not have even an advisory role in the conduct of the case of *Laird v. Tatum*."[157] He also declined to disqualify himself through an exercise of discretion, reasoning that opinions on the law and policy were necessary and inevitable,[158] and that having publicly expressed these opinions was not sufficient grounds for disqualification.[159]

152. Cipollone v. Liggett Group, Inc., 802 F.2d 658, 659-60 (3d Cir. 1986) (judge's prior knowledge of issues in products liability suit against tobacco companies not grounds for disqualification), *cert. denied*, 107 S. Ct. 907 (1987).

153. 408 U.S. 1 (1972) (suit against army surveillance dismissed); 409 U.S. 824 (1972) (memorandum of Rehnquist, J., rejecting motion for disqualification).

154. 408 U.S. at 2.

155. 409 U.S. at 824-25.

156. *Id.*

157. *Id.* at 829. The revised version of § 455 has not yet been enacted. For the text of the disqualification statute in effect at the time, *see supra* note 28.

During the hearing process prior to Justice Rehnquist's confirmation as Chief Justice, information regarding his role in formulating the surveillance program became public and prompted criticism of his failure to disqualify himself in *Tatum*. Members of Congress and the legal community maintained that his involvement in policy-making required disqualifications. *See Rehnquist's Critics Press Charges That He Was Unethical on Court*, N.Y. Times, Sept. 11, 1986, p. B12, col. 1 (statements of Hazard, an expert on judicial ethics and a Republican, to the effect that Rehnquist should have disqualified himself in *Tatum*); *Rehnquist Acted Improperly by Ruling On Surveillance Case, Ethics Expert Says*, Wall St. J., Sept. 11, 1986, at 64, col. 1 (Yale Law School Professor Geoffrey Hazard statements that Rehnquist should not have participated in *Tatum* because of direct involvement in events that culminated in suit); *New Questions Raised About Rehnquist's Role in Army Surveillance of Protestors*, Wall St. J., Sept. 10, 1986, at 64, col. 1 (Senate Democrats state that information regarding Rehnquist's involvement in formulating surveillance policy raises questions regarding his ethical judgment and sensitivity to the appearance of impropriety).

158. 409 U.S. at 835.

159. *Id.* at 836. Justice Rehnquist also argued that federal judges have a "duty to sit" if not disqualified. *Id.* at 837. Congress specifically rejected this rule when it passed the revised disqualification statute later that same year. *See supra* note 30 and accompanying text for a discussion of the duty to sit.

In its revision of section 455, Congress included a specific provision, section 455(b)(3),[160] to address issues raised in *Tatum*.[161] Section 544(b)(3) does not, however, clearly require disqualification where a judge is ruling on the applicability or constitutionality of laws or executive policies that he had a significant hand in shaping. Section 455(b)(3), on its face, seems to be applicable only in those cases in which a judge had been involved in, or expressed an opinion about, a particular case. Disqualification in circumstances like those presented in the *Tatum* case would fall, instead, under the general provision of section 455(a), which requires the court to ask whether the judge's participation in lawmaking raises reasonable doubts concerning his impartiality. It is reasonable to believe that one who has had a significant part in formulating a policy may have difficulty maintaining impartiality when that policy is challenged.

The disqualification issue may also arise when a judge has not played a significant role in formulating policy but rather has expressed an opinion on an issue, either by casting a vote in a legislature, or by publicly expressing an opinion. Courts have generally refused to disqualify judges in these circumstances.[162] Nevertheless, evidence of strongly held opinions can raise reasonable doubts about a judge's impartiality.

In *Southern Pacific Communications v. American Telephone & Telegraph Co.*,[163] the United States Court of Appeals for the District of Columbia considered the issue of disqualification based on emphatic policy statements in post-trial review of an antitrust case against American Telephone & Telegraph Co. ("AT&T"). The district court judge, in his memorandum opinion,[164] forcibly stated his belief that the public interest was better served by an AT&T monopoly rather than by competition in the telecommunications industry.[165] The court of appeals, noting that views on the law and policy do not ordinarily disqualify a judge,[166] allowed for the possibility of disqualification if the court prejudged a case.[167] The court set forth an "irrevocably closed mind" test for determining

160. *See supra* note 12 for text of § 455(b)(3).

161. *See Senate Hearings*, *supra* note 2, at 88-89 (need for § 455(b)(3) explained by reference to *Laird v. Tatum*).

162. *See, e.g.*, Shaw v. Martin, 733 F.2d 304, 315-16 (4th Cir.) (vote for death penalty no more significant than oath binding judges to apply laws of legislature; it is not grounds for disqualification), *cert. denied*, 469 U.S. 873 (1984); United States v. Allen, 675 F.2d 1373, 1385 (9th Cir. 1980) (statement that marijuana importation is a serious crime with cancer-like effect on society is restatement of congressional purpose and cannot be grounds for disqualification), *cert. denied*, 454 U.S. 833 (1981); Smith v. Danyo, 585 F.2d 83, 87 (3d Cir. 1978) (statement that diversity cases do not belong in federal court is statement of legal principle and does not disqualify judge); *see also* Lawton v. Tarr, 327 F. Supp. 670, 671-72 (E.D.N.C. 1971) (judge who had publicly expressed his strong objection to Vietnam war refused to disqualify himself from Selective Service case).

163. 740 F.2d 980 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1005 (1985).

164. Southern Pacific Communications Co. v. American Tel. & Tel. Co., 556 F. Supp. 825 (D.D.C. 1982), *aff'd*, 740 F.2d 980 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1005 (1985).

165. 740 F.2d at 983, 988 n.7.

166. *Id.* at 990.

167. *Id.* at 991.

FOIA # 57720 (URTS 16326) Doc 70105318 Page 383

when a judge's actions overcome the presumption of impartiality.[168]

The *Southern Pacific Communications* "irrevocably closed mind" test cannot be applied to pretrial disqualification, however. Pretrial application of the test would conflict with the presumption that a judge will maintain an open mind toward a case, and follow precedent faithfully.[169] In a section 455(a) pretrial disqualification challenge, this presumption would preclude challenge of a judge's impartiality prior to trial because it would not be possible to prove that an upcoming presentation of an issue would not sway the judge.[170] A litigant cannot make a pretrail showing of an "irrevocably closed" mind sufficient to overcome the presumption when such a showing depends on evidence of bias in the proceedings.[171]

Although in general a judge may not be disqualified for an opinion on the law, a judge may be disqualified for holding a fixed opinion regarding sentencing.[172] This exception was established in *United States v. Thompson*,[173] the case in which the defendants had allegedly violated the Selective Service Act.[174] The district court judge, in a previous case, had announced that it was his policy to sentence all Selective Service Act violators to at least thirty months in jail.[175]

168. *Id.* The court suggested that judges should not be disqualified if they are "capable of refining" their views in the process of the case, but they should be disqualified if their minds are "irrevocably closed." *Id.* Applying this test to the district court judge's handling of the AT&T case, the court found that the judge did not hold a fixed opinion at the outset of the case, as evidenced by his denial of a motion to dismiss the case on the basis of antitrust immunity, and that his evenhanded administration of the case provided no evidence of a "closed mind" during trial. *Id.* at 991-92.

169. *See id.* at 993 (evidence must be weighed against strong presumption that judges do not substitute their personal views for controlling law).

170. *Cf.* Bloom, *supra* note 55, at 689 (previously stated opinion on important issue in case could lead reasonable person to question judge's impartiality).

Bloom addressed this issue prior to the circuit court decision in *Southern Pacific Communications*. He perceived the policy against disqualifying judges for opinions on the law as a blanket prohibition, rather than as a policy giving rise to a strong presumption of impartiality. *Id.* at 688. Bloom advocated replacing the blanket prohibition with a case-by-case analysis that would disqualify judges for the appearance of bias, and that would take into account "whether and how widely the judge's views are publicly known, how strongly the views are held, whether the proper resolution of the legal issue is unsettled, and whether his views relate to the legal issue as applied in the specific factual context of the case . . . ." *Id.* at 697.

171. *See Southern Pacific Communications*, 740 F.2d at 991 (each new case confronts judge with new factual context, new evidence, and new efforts at persuasion; test is whether judge's mind is irrevocably closed with respect to issues as they arise in context of specific case).

172. *See* United States v. Clements, 634 F.2d 183, 187 (5th Cir. 1981) (fixed sentencing policy, established through judge's statement or prior record in similar cases, may disqualify); United States v. Thompson, 483 F.2d 527, 528-29 (3d Cir. 1973) (judge's statement showing policy of imposing stiff sentences for Selective Service violations grounds for disqualification).

173. 483 F.2d 527 (3d Cir. 1973). Although the *Thompson* court held that a litigant can disqualify a judge through a pretrial § 144 affidavit alleging a fixed sentencing policy, the court was evaluating a case in which the judge had declined to disqualify himself, *id.* at 528, and had actually imposed the thirty-month sentence he had indicated was his minimum. *Id.* The court, however, focused on the allegations in the affidavit, rather than the judge's conduct in the case. *Id.* at 528-29.

174. *Id.* at 528.

175. *Id.* *See* United States v. Townsend, 478 F.2d 1072, 1074 (3d Cir. 1973) (judge disqualified for statement showing fixed opinion on sentencing).

The appellate court determined that this allegation provided grounds for disqualification because it "was not an allegation of judicial bias in favor of a particular legal principle," but rather of personal bias "directed against the appellant as a member of a class."[176] The court also noted, however, that a fixed policy as to sentencing was inconsistent with the trial judge's authorized discretion to tailor sentences appropriately.[177]

The *Thompson* court's consideration of the judge's violation of his official duties suggests a framework for a narrow exception permitting disqualification for opinions on the law or public policy. Courts could adopt the rule that while policy statements should not generally provide grounds for disqualification, an exception will be made when a statement or action would lead a reasonable person to conclude that the judge is predisposed to violating his or her oath or ignoring a mandate.[178] Such a rule would not interfere with the present practice of refusing disqualification when the judge's statement expresses an enthusiastic commitment to enforce the law,[179] or when a judge previously voted in favor of a law applicable in the case.[180] Simple disagreement with existing law would also not disqualify.[181] Under the proposed exception, however, the presumption of impartiality could be overcome if a judge's action provided evidence of intense disagreement with a particular policy or law.[182] The critical issue would be whether the judge could reasonably be expected to put aside his or her personal feelings, rather than allow them to dominate the decision-making process.[183]

c. *Bias or prejudice toward an attorney*

Some courts have required that judicial bias be directed toward the party as an individual, rather than toward that party's attorney, before disqualifying a

176. 483 F.2d at 529. One member of the circuit court panel filed a dissent in which he argued that the class was a judicial one, defined merely by their violation of the Selective Service Act, and not by a "trait extraneous to the judicial process." *Id.* at 530 (Adams, J., dissenting).

177. *Id.* at 529.

178. *See* Reserve Mining Co. v. Lord, 529 F.2d 181, 188-89 (8th Cir. 1976) (judge disqualified for disregarding appeals court mandate regarding district court jurisdiction).

179. *See* United States v. Allen, 675 F.2d 1373, 1385 (9th Cir. 1980) (anti-drug statement not grounds for disqualification in drug smuggling trial), *cert. denied*, 454 U.S. 833 (1981).

180. *See* Shaw v. Martin, 733 F.2d 304, 316 (4th Cir.) (judge who as legislator had voted for death penalty not disqualified), *cert. denied*, 105 S. Ct. 230 (1984).

181. Courts have shown an appropriate reluctance to disqualify on the basis of disagreement with applicable law. The *Southern Pacific Communications* court articulated the reason for this reluctance when it stated:

> It is well established . . . that a judge is not disqualified merely because he personally disagrees with the policy underlying a law that he is bound to apply in a case [since] . . . '[i]n fulfilling the functions of applying or considering the validity of a statute, or a government program, the judge endeavors to put aside personal views as to the desirability of the law or program . . . .'

740 F.2d at 993 (quoting Association of Nat'l Advertisers, Inc. v. FTC, 627 F.2d 1151, 1175 (D.C. Cir. 1979) (Leventhal, J., concurring), *cert. denied*, 447 U.S. 921 (1980)).

182. For example, a judge who had previously campaigned for political office on an anti-abortion platform could be disqualified from abortion cases.

183. *See Southern Pacific Communications*, 740 F.2d at 993 (allegation that judge allowed feelings to dominate considered but rejected on basis of record).

FOIA # 57720 (URTS 16326) Doc ID: 70105318 Page 384

judge.[184] Under section 455(a), however, bias or antipathy directed at counsel may justify disqualification, but only if this bias or prejudice could affect the outcome of the case to the detriment of a party.[185] As the United States Court of Appeals for the Tenth Circuit noted in *United States v. Ritter*,[186] "if a judge is biased in favor of an attorney, his impartiality might reasonably be questioned in relationship to the party."[187]

Yet, as the Ninth Circuit has noted, when a judge is charged with prejudice against an attorney, the court must take into account tensions between judge and attorney inherent in the adversarial system.[188] A disqualification motion based on bias for or prejudice against an attorney thus should be evaluated in context, like other charges of prejudice arising from a judge's statements or actions within the judicial process.

d. *General background and experience*

Reviewing courts also refuse to disqualify judges on the basis of their general background, education, and experience.[189] In *Blank v. Sullivan & Cromwell*,[190] a sex discrimination case against a law firm, the defendant sought to disqualify the judge because she was female and as a lawyer had worked on behalf of minorities who had suffered from discrimination.[191] The *Blank* court refused to disqualify, reasoning that if background, race, or sex were in themselves grounds for removal, "no judge on this court could hear this case, or many others, by virtue of the fact that all of them were attorneys, of a sex, [and] often with distinguished law firm or public service backgrounds."[192]

184. *See* Davis v. Board of School Comm'rs, 517 F.2d 1044, 1052 (5th Cir. 1975) (disqualification should be based on judicial bias toward a party rather than counsel), *cert. denied*, 425 U.S. 944 (1976); *cf.* Gilbert v. City of Little Rock, 722 F.2d 1390, 1298-99 (8th Cir. 1983) (judge who voluntarily disqualified herself from cases involving certain attorney not required to disqualify herself from case in which that attorney had previously represented party because antipathy to attorney insufficient grounds for disqualification on personal prejudice), *cert. denied*, 466 U.S. 972 (1984).

185. *See, e.g., In re* International Business Machs. Corp., 618 F.2d 923, 932 (2d Cir. 1980) (court considered incidents of intemperate behavior toward attorneys and concluded they did not show bias toward party).

186. 540 F.2d 459 (10th Cir. 1976), *cert. denied*, 429 U.S. 951 (1976).

187. *Id.* at 462.

188. *In re* Yagaman, 796 F.2d 1165, 1178 (9th Cir. 1986) (tension between court and attorney did not create bias toward party). The court described this tension as a normal component of the judicial process, stating that "[b]ecause the nature of our system is adversarial, parties will occasionally be uncooperative, both with each other and with the court, and courts will sometimes be exacting." *Id. See also In re* International Business Machs. Corp., 618 F.2d at 932 (incidents of intemperate behavior "endemic to a trial of this dimension").

189. *See* Paschall v. Mayone, 454 F. Supp. 1289, 1300-01 (S.D.N.Y. 1978) (judge not disqualified for experience as an NAACP attorney).

190. 418 F. Supp. 1 (S.D.N.Y. 1975).

191. *Id.* at 4.

192. *Id.* Disqualification sought on the basis of a judge's background and experience was also rejected in Pennsylvania v. Local 542, Int'l Union of Operating Eng'rs, 388 F. Supp. 155, 182 (E.D. Pa. 1974), *aff'd*, 552 F.2d 498 (3d Cir. 1977). The defendants, who were charged with discriminating against a class of black plaintiffs on the basis of race, sought to disqualify Judge Higginbotham by means of a § 144 affidavit alleging that he was black and had identified himself with black causes.

Rejection of recusal for general background or experience is sensible because evidence of general associations does not provide a reasonable basis for an inference of bias.[193] Courts must, however, carefully distinguish between general evidence of background or associations and specific evidence that may provide a basis for disqualification under section 455(a) if an interest or relationship is not specified under section 455(b).[194]

2. Grounds for Disqualification Under Section 455(a) Other Than Bias or Prejudice

Disqualification under section 455(a) is not limited to circumstances where bias or prejudice is explicitly alleged; section 455(a) also applies when an interest or relationship, not among those defined by section 455(b), raises doubt about a judge's impartiality.[195] It is evident from the record of the Senate committee hearing on the proposed revision of section 455 that Congress envisioned the use of section 455(a) as a tool for disqualification on grounds not specified in section 455(b).[196]

Recognizing the scope of the general provisions, courts have made use of section 455(a) to disqualify judges for interests or relationships not covered by section 455(b).[197] Several courts have used section 455(a) as their framework for examining disqualification motions that allege that a judge's law clerk or former law clerk had a role or an interest in a case.[198] The United States Court of Appeals for the Third Circuit has held that judges are required under section 455(a) to disqualify themselves from criminal actions if they have a substantial interest in the victim of the crime.[199] The Fifth Circuit, in *Potashnick v. Port*

Id. at 157-58. The defendant's central allegation was that Judge Higginbotham's recent speech before a black history organization revealed his identification with civil rights cases. *Id.* at 159-60, 163. In addition to refusing disqualification on the grounds that background and associations could not be used to prove bias, the judge noted that dedication to upholding the law also could not be used to disqualify a judge. *Id.* at 159.

See also Brody v. President & Fellows of Harvard College, 664 F.2d 10, 11 (1st Cir. 1981) (fact that judge graduated from Harvard College does not disqualify him from hearing suit against Harvard), *cert. denied*, 455 U.S. 1027 (1982).

193. *See* Note, *Meeting the Challenge: Rethinking Judicial Disqualification*, 69 CALIF. L. REV. 1445, 1461 (1981) (simplistic allegations of bias based on implications from background rightfully given short shrift).

194. *See infra* notes 195-220 and accompanying text for a discussion of disqualification for an interest or relationship under § 455(a).

195. *See supra* note 12 for the text of 28 U.S.C. § 455.

196. *See Senate Hearing, supra* note 2, at 112 (relationship not specified under § 455(b) may raise question of impartiality under § 455(a)).

197. *See infra* notes 207-20 and accompanying text for a discussion of cases in which § 455(a) disqualification was based on an interest or relationship.

198. *See* Patzner v. Burkett, 779 F.2d 1363, 1372 (8th Cir. 1985) (disqualification not mandated where defense attorney had served judge as law clerk more than a year before in light of circuit rule that prohibited law clerks from appearing before their judge within a year of their service); Hall v. Small Business Admin., 695 F.2d 175, 179 (5th Cir. 1983) (judge disqualified because current law clerk had interest in case).

199. United States v. Nobel, 696 F.2d 231, 235 (3d Cir. 1982) (judge disqualified for holding stock in corporate victim of fraud), *cert. denied*, 462 U.S. 1118 (1983).

FOIA # 57720 (URTS 16326) Doc: 70105318 Page 385

City Construction Co.,[200] relied on section 455(a) to disqualify a judge who had extensive business dealings with the plaintiff's attorney.[201] More recently, the Fifth Circuit used section 455(a) in *Health Services Acquisition Corp. v. Liljeberg*[202] to disqualify a judge who claimed he had no knowledge of information that, if known, would have disqualified him under section 455(b)(4).[203]

In each of these cases, the respective appellate court determined that a relationship or interest in itself raised questions regarding impartiality. The courts did not evaluate the extent of the relationship or interest to determine whether the judge in each case was actually biased. Rather, the courts disqualified due to the appearance of bias.[204]

Casting disqualification questions in terms of relationships or interests, instead of in terms of bias, has several advantages. Stating the disqualification motion in terms of a questionable relationship can bring into clearer focus the grounds for objecting to the participation of a particular judge.[205] In addition, relationships and interest are easier for courts to ascertain because the evidence is more concrete and accessible. Such decisions are also easier to review, since the court can consider, as a matter of law, whether a particular interest or relationship should be added to the list of those that disqualify.[206] Furthermore, resting the need for disqualification on the existence of a relationship is less personal and may be easier for a judge to view objectively than a direct charge of bias.

Nevertheless, litigants and courts tend to treat any relationship or interest not specifically enumerated in Section 455(b) as presenting a question of disqualification for bias or prejudice, requiring the more difficult showing of personal prejudice, rather than considering the relationship under section 455(a). The opinion issued by the Fifth Circuit in *United States v. Harrelson*[207] provides an

200. 609 F.2d 1101 (5th Cir.), *cert. denied*, 449 U.S. 820 (1980).

201. *Id.* at 1110-12; *see also Pepsico, Inc.*, 764 F.2d at 461 (disqualification required where judge indirectly sought employment in firm of attorney appearing before him).

202. 796 F.2d 796 (5th Cir. 1986).

203. *Id.* at 800-02. 28 U.S.C. § 455(b)(4) requires disqualification if a judge "knows that he, individually or as a fiduciary . . . has a financial interest in the subject matter in controversy . . . ." The court held that the judge, who was a trustee of Loyola University, had "constructive knowledge" of an interest in the case because he had attended a meeting at which financial information was disseminated that revealed the university's interest. 796 F.2d at 803. The court concluded that the judge's claimed forgetfulness could not provide a defense against disqualification under the objective standard of § 455(a) and thus held that the judge's recusal was necessary. *Id.* at 802-03. *Cf.* Davis v. Xerox, 811 F.2d 1293 (9th Cir. 1987) (if reasonable person would conclude that judge had no knowledge of interest at time rulings made, § 455(a) does not require that rulings be vacated).

204. *See, e.g., Nobel*, 696 F.2d at 235 (disqualification depends on appearance of bias); Hall v. Small Business Admin., 695 F.2d 175, 178 (5th Cir. 1983) (inappropriate under § 455(a) to inquire into actual bias of judge).

205. *See, e.g.*, United States v. Story, 716 F.2d 1088, 1090-91 (6th Cir. 1983) (personal bias charged but court addressed as real issue whether judge should be disqualified for prior association with charity which was victim of crime).

206. *See Nobel*, 696 F.2d at 234 (question of whether judge is disqualified for financial interest in corporate victim of crime is a question of law).

207. 754 F.2d 1153 (5th Cir. 1985), *cert. denied*, 106 S. Ct. 277 (1985).

example of this tendency. The *Harrelson* defendants were convicted of murder and conspiracy to murder a federal judge.[208] Pursuant to section 455(a), the defendants had sought to disqualify the trial judge, who had known and worked with the murder victim for eight or nine years, served as an honorary pallbearer at his funeral, and eulogized him at several memorial ceremonies.[209] The court analyzed section 455(a) as requiring disqualification on the basis of conduct that shows personal prejudice, insisting that "recusal is not warranted absent specific instances of conduct indicating prejudice against a defendant."[210] Because such evidence was lacking, the court held that disqualification was not required.[211]

The *Harrelson* court then considered the question of relationship briefly and superficially.[212] The court reasoned that a trial judge in this position may harbor hostility toward the actual killers but would presume the innocence of persons pleading not guilty.[213] The court did not consider the possible impact of this hostility if the judge reached a conclusion regarding guilt before the end of the trial or its possible impact upon sentencing.[214] The court concluded that absent a stronger showing of personal prejudice, a reasonable person would not presume that the "careful and seasoned trial judge" was biased.[215] By requiring a showing of personal prejudice,[216] the court lost sight of the objective "appearance of bias" standard established in section 455(a) as applied to questions of disqualifying relationship or interest.

Other courts have given questions involving a relationship equally short shrift. For example, in *United States v. Balistrieri*,[217] disqualification was sought on the grounds that the judge, when he was Wisconsin Attorney General, identified the defendant as the head of an organized crime family and targeted the defendant's family business for investigation in his efforts against organized crime.[218] The court denied disqualification on the grounds that there was no showing of personal animus[219] and did not ask whether a reasonable person would consider the relationship of the judge to the defendant one which called into doubt the impartiality of the judge.[220]

208. *Id.* at 1158-59.

209. *Id.* at 1164-65.

210. *Id.* at 1165.

211. *Id.* at 1166.

212. *Id.*

213. *Id.*

214. The question whether a personal relationship with the victim of a crime constitutes a disqualifying relationship is not settled. *Compare* United States v. Nobel, 696 F.2d 231, 235-36 (3d Cir. 1982) (concern for maintaining public confidence in judicial integrity, which "depends on a belief in the impersonality of judicial decisionmaking," requires disqualification of judge with financial interest in corporate victim of crime), *cert. denied*, 462 U.S. 1118 (1983) *with* United States v. Sellers, 566 F.2d 884, 887 (4th Cir. 1977) (fact that judge owned stock in bank that was victim of robbery did not create reasonable apprehension that judge would be partial).

215. 754 F.2d at 1166.

216. *Id.*

217. 779 F.2d 1191 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 1490 (1986).

218. *Id.* at 1200.

219. *Id.* at 1201.

220. *Compare id.* at 1201-02 (disqualification not required of judge who, as Attorney General,

FOIA # 57720 (URTS 1632 ... d: 70105318 Page 386

The tendency of courts to focus on personal prejudice suggests that a subjective element remains in disqualification decisions under section 455(a) despite the congressional emphasis on an objective standard. The next section will examine the disqualification decision-making process and consider means for achieving greater objectivity in disqualification under section 455(a).

III. Disqualification Procedure

A. Disqualification Decision-Making

Objective disqualification can be promoted by clarifying the process of evaluating evidence for disqualification. The inherently subjective nature of evidence of personal bias and prejudice may make objective evaluation difficult.[221] Yet even when disqualification is based on bias or prejudice, courts are required by Congress to apply the objective standard of section 455(a).[222]

The decision-making process followed when disqualification is based on an interest or relationship defined under section 455(b)[223] is simple to describe and provides a framework for a more objective approach to disqualification under section 455(a). In deciding whether to disqualify for interest or relationship, the first question a court poses is: does the interest or relationship exist? If it does, the court must arrive at an accurate description of the relationship and ask: does the judge's interest or relationship fall within those specified under section 455(b)? If so, disqualification is automatic.[224] The statute imposes the presumption that the particular interest or relationship would reasonably result in bias.[225]

If the interest or relationship is not one specified under section 455(b), the next question posed is whether this interest or relationship reasonably raises questions regarding a judge's impartiality.[226] Once the factual determination is

allegedly focused on defendant as organized crime figure) *with* Bradshaw v. McCotter, 785 F.2d 1327, 1329 (5th Cir. 1986) (habeas corpus relief granted because appellate judge, who had been state prosecuting attorney at time party was prosecuted and whose name appeared on state's brief, should have disqualified himself even though name appeared on brief as a matter or protocol and judge had not participated in prosecution), *modified on reh'g*, 796 F.2d 100, 101 (5th Cir. 1986) (although judge disqualified, habeas corpus relief not granted because judge's vote on appeal not controlling). *See also* Idaho v. Freeman, 507 F. Supp. 706, 731-33 (D. Idaho 1981) (in case in which plaintiffs sought extension of deadline for ratification of ERA, disqualification on basis of judge's holding responsible office in Mormon Church, which had taken stand and engaged in lobbying efforts against ERA, denied by challenged judge on grounds that he had never participated in anti-ERA lobbying nor made his personal position known).

221. *Cf.* Moore, *Appellate Review of Judicial Disqualification Decisions in the Federal Courts*, 35 Hastings L.J. 829, 846 (1984) (disqualification on the basis of bias or prejudice inherently subjective, requiring different treatment on review).

222. 28 U.S.C. § 455(a) (1982).

223. *Id.* § 455(b).

224. *See supra* notes 14-20 and accompanying text for a discussion of the statutory provisions mandating disqualification for interest or relationship.

225. *Id.*

226. *See supra* notes 195-220 and accompanying text for a discussion of disqualification under § 455(a) on the basis of interest or relationship. *See also* Aetna Life Ins. Co. v. Lavoie, 106 S. Ct.

made regarding the existence of an interest or relationship, the question whether it provides reasonable grounds for disqualification is one an appellate court can determine as a matter of law.[227]

In cases seeking disqualification on the basis of personal bias or prejudice, the judge's statements and other expressive actions provide the evidence for disqualification.[228] To make an objective assessment of this evidence, the court must first test its accuracy, and question whether the event or statement occurred as reported. Once the court has obtained an accurate description of the expressive act that may reveal bias, that evidence must be evaluated using the reasonable person standard to determine whether the expressive acts reasonably raise doubts regarding the judge's impartiality.[229] Under the objective standard, it is inappropriate for the court to inquire further and attempt to determine the judge's actual state of mind. The court is limited to assessing outward manifestations and to making a reasonable inference as to whether the typical judge would be biased under those circumstances.[230]

The task of applying the objective standard to the facts grants the judge a degree of discretion in disqualification decisions under section 455(a) that is not present in section 455(b) decisions. The scope of that discretion is limited, however, because Congress established a low threshold when it eliminated the duty to sit.[231] Judges are required to recuse themselves if they perceive any grounds for disqualification.[232] The discretion of district court judges can be limited further by the courts of appeals if they respond to disqualification cases by establishing clearer guidelines for disqualification.[233]

1580, 1587 (1986) (reviewing court not required to decide whether judge is actually biased by interest but only whether normal average judge would be biased in circumstances).

227. *See* Pepsico, Inc. v. McMillen, 764 F.2d 458, 461 (7th Cir. 1985) (disqualification mandated where judge in negotiation for employment with law firm or party appearing before him); United States v. Nobel, 696 F.2d 231, 235-36 (3d Cir. 1982) (court adopted rule that judge is disqualified for financial interest in victim of crime), *cert. denied*, 462 U.S. 1118 (1983).

228. *See supra* notes 109-93 and accompanying text for a discussion of judicial requirements for disqualification for bias or prejudice.

229. *See, e.g.*, Roberts v. Bailar, 625 F.2d 125, 129 (6th Cir. 1980) (remark undisputedly made by judge must be evaluated on objective standard that asks whether a reasonable person with knowledge of all the facts would doubt judge's impartiality).

230. *See* Hall v. Small Business Admin., 696 F.2d 175, 179 (5th Cir. 1983) (inquiry into the state of mind of a judge not part of the objective test); Roberts v. Bailar, 625 F.2d at 129-30 (judge's statement regarding his assessment of supervisor's character in employment discrimination suit disqualified him under the objective standard; court did not consider and explicitly rendered no opinion regarding existence of actual bias).

231. *See supra* note 30 and accompanying text for a discussion of the elimination of the duty to sit.

232. *Id.*

233. *See, e.g.*, Roberts v. Bailar, 625 F.2d at 129-30 (judge's statement assessing character of key person in lawsuit disqualifies judge); Nicodemus v. Chrysler Corp., 596 F.2d 152, 155-56 (6th Cir. 1979) (outburst against party unsupported by record grounds for disqualification); United States v. Thompson, 483 F.2d 527, 529 (3d Cir. 1973) (fixed opinion on sentencing disqualified judge).

EDIA#52720[URIS16326] Doc 70105318 Page 387

B. Evaluation by the Challenged District Court Judge

Federal law provides that the decision-making process described above be carried out by the judge who is under challenge. Under section 144, which provides for disqualification upon filing of a sufficient affidavit,[234] the challenged judge is charged with determining whether the affidavit is legally sufficient.[235] Although the judge is required to assume the truth of the allegations and the good faith of the attorney regardless of any knowledge to the contrary,[236] the judge exercises significant power over disqualification. The requirement of convincing evidence of bias,[237] and the restrictions on disqualification evidence such as the extrajudicial source rule,[238] give the challenged judge the responsibility of making an extensive evaluation of the charges.[239]

Under section 455, judges have more latitude in reaching the decision whether to disqualify themselves. Judges are not required to accept the veracity of the factual averments in a motion, but rather are free to make credibility determinations, weigh the evidence, and contradict it with facts drawn from their own personal knowledge.[240]

Giving the challenged judge this role in the disqualification process has the advantage of allowing the judge with the best knowledge of the issue to resolve it speedily. But when the judge denies disqualification, questions regarding that judge's impartiality are compounded rather than settled. Moreover, the appearance of impartiality is not advanced when a challenged judge proceeds to try a case and there has been no outside assessment of the challenge to that judge's impartiality.[241]

234. 28 U.S.C. § 144 (1982). *See supra* notes 35-43 and accompanying text for a discussion of § 144 requirements.

235. Berger v. United States, 225 U.S. 22, 36 (1921).

236. *Id.*

237. *See supra* notes 69-73 and accompanying text for a discussion of the standard of proof under § 144.

238. *See supra* notes 109-94 and accompanying text for a discussion of the judicial limitations on disqualification.

239. To determine the legal sufficiency of a § 144 affidavit, a judge must consider whether it is definite enough in its pleadings, whether the kind of prejudice it alleges is judicially recognized as grounds for disqualification, and, if so, whether the facts it alleges would convince a reasonable person that the judge is biased. *See supra* note 69 for the three-part test for legal sufficiency generally applied by the courts.

240. United States v. Balistrieri, 779 F.2d 1191, 1202 (7th Cir. 1985), *cert. denied*, 106 U.S. 1490 (1986); *see also* Hall v. Small Business Admin., 695 F.2d 175, 179 (5th Cir. 1983) (judge must evaluate disqualification motion from perspective of reasonable person with knowledge of all objective facts); Potashnick v. Port City Constr. Co., 609 F.2d 1101, 1111 (5th Cir.) (disqualification required if reasonable person with knowledge of circumstances would harbor doubts about judge's impartiality), *cert. denied*, 449 U.S. 820 (1980); Blizard v. Frechette, 601 F.2d 1217, 1220 (1st Cir. 1979) (disqualification required if reasonable person would have factual grounds for doubting judge's impartiality).

241. *See, e.g., In re* International Business Machs. Corp., 618 F.2d 923, 927 (2d Cir. 1980) (intolerable to judicial system to allow challenged judge to terminate inquiry of prejudice until ultimate review on merits).

C. Other Means for Determining Disqualification

Commentators have proposed several ways of changing or supplementing disqualification procedures to better ensure an impartial adjudicator. One proposed alternative to the current disqualification procedure is to eliminate judicial decision-making from the process by instituting the peremptory challenge of judges.[242] Reliance on peremptory challenge, however, may lead to judge-shopping[243] and inefficiency.[244] Furthermore, the introduction of a peremptory challenge would not actually address the problem of ensuring impartial judges. The proposals limit litigants to one use of a peremptory challenge.[245] Litigants could face a biased judge after reassignment and the need for a statute disqualifying judges for cause would remain, as would the problems of achieving disqualification on an objective standard under such a statute.

The other two proposed alternatives, which would bring judges other than the challenged judge into the disqualification process, deserve more extensive consideration. One proposal is to transfer the decision to another judge at the district court level. A second alternative is to allow full and immediate appellate review of denials of disqualification.

1. Transfer to Another District Judge

Commentators have recommended that independent adjudication of disqualification motions be assured by requiring that a district court judge presented with a disqualification motion transfer the motion to another judge for decision.[246] Such a transfer would, according to commentators, address the problem presented by having judges decide their own cases, provide a more disinterested forum, and thus promote the appearance of impartiality.[247] The major objection commentators have leveled against this proposal is that transfer of

242. *See* Comment, *Disqualification of Federal District Judges—Problems and Proposals*, 7 SETON HALL L. REV. 612, 633-36 (1976) (automatic disqualification upon filing of motion recommended as efficient method that protects judges' reputations since it avoids discussion of actual or apparent bias); Note, *Disqualification of Federal District Judges for Bias Under 28 U.S.C. Section 144 and Revised Section 455*, 45 FORDHAM L. REV. 139, 159-63 (1976) (disqualification by peremptory challenge "best way to rectify the existing deficiencies" in disqualification process).

243. *See* Note, *supra* note 193, at 1471-72 (judge-shopping most common abuse of California peremptory challenge provision).

244. *Id.* at 1472-73 (delays and judicial waste in California results from peremptory challenge rule).

245. *See Senate Hearing*, *supra* note 2, at 7-8, 13 (S. 1886, introduced by Senator Bayh, allowed one peremptory challenge per side).

246. To make transfer of disqualification decisions mandatory would require amendment of the current statute, 28 U.S.C. § 455, which explicitly places the responsibility for disqualification on the challenged judge. *See supra* note 12 for the text of § 455. *See also* Comment, *supra* note 75, at 266 n.172, for a discussion of creative ways to circumvent the current requirement that judges disqualify themselves.

247. *See* Bloom, *supra* note 55, at 697, 706 (decision should be referred to another district court judge to enhance appearance of impartiality); Redish & Marshall, *supra* note 1, at 503 n.180 (to make right to non-biased adjudicator meaningful, parties should be afforded opportunity to present their case for disqualification before judge other than the person challenged); Comment, *supra* note 75, at 265-67 (courts should encourage transfer at discretion of challenged judge); Note, *supra* note

FOIA # 57720 (URTS 16326) Do[illegible]70105318 Page 388

the disqualification motion to another judge for a hearing, or for review of affidavits,[248] would delay litigation and impose an administrative burden.[249] Those advocating this alternative argue that an independent review of disqualification is worth the delay and burden on the courts.[250]

2. Appellate Review

Another means for insuring independent assessment of disqualification decisions is to afford litigants immediate and comprehensive review of disqualification denials. Immediate appellate review would clearly further the goals of judicial disqualification. Without interlocutory review, trials proceed before judges whose impartiality is in question, thereby imposing upon litigants a possibly unfair trial and undermining the public perception of the impartiality of judges.[251]

Nevertheless, routine interlocutory consideration of disqualification would impose a burden on the courts. Timely appeal may, however, reduce the burden imposed on the judicial system when a new trial is necessitated following reversal based on disqualification.[252] Moreover, resolution of a disqualification issue at pretrial is less complex than resolution of the disqualification question as part of a completed case. In post-trial review, a new trial may be required even though everything but the disqualification issue appears to have been correctly decided.[253] In this position, a court may be reluctant to apply the liberal standards instituted by Congress which address the disqualification question.

Unfortunately, timely review of disqualification denials is impeded by statutory limitations on interlocutory review. Disqualification motions are usually raised and decided before the trial.[254] A final decision on the merits of a case is

193, at 1484 ("mini-hearing review" of affidavits on district court level best solution to problems with disqualification process).

248. *See* Note, *supra* note 193, at 1484 (refer disqualification questions to presiding judge to decide solely on basis of affidavits).

249. *See* Comment, *supra* note 75, at 265-66 (transfer policy could be used for delay and could be disruptive in states or territories with only one or two federal judges).

250. *See* Bloom, *supra* note 55, at 697 (administrative burden may be worth paying to enhance appearance of judicial impartiality); Comment, *supra* note 75, at 265-66 (transfers would produce more disinterested decision and spare judge embarrassment of ruling; best to make practice of transferring except where delay or disruption substantial).

251. *See* Redish & Marshall, *supra* note 1, at 504 n.180 (to allow litigant to go through trial with biased judge is at odds with Supreme Court pronouncement that due process affords right to impartial judge at all stages of process); *see also* Moore, *supra* note 226, at 851 (permitting trial before judge who is or appears to be biased constitutes enormous encroachment on fundamental value of impartiality).

252. *See, e.g.*, Roberts v. Bailar, 625 F.2d 125, 126 (6th Cir. 1980) (remanded for new trial because disqualification required under § 455); Potashnick v. Port City Constr. Co., 609 F.2d 1101, 1104 (5th Cir.) (reversed because judge should have disqualified himself; remanded for new trial before different judge).

253. *See, e.g.*, United States v. Harrelson, 754 F.2d 1153 (5th Cir.) (court faced with whether to grant new trial to person convicted of murdering district court judge), *cert. denied*, 106 S. Ct. 599 (1985).

254. Section 144 contains a timeliness requirement. *See supra* note 37 for discussion of the timeliness requirement under § 144. Section 455 does not contain any such requirement. In SCA

generally required, however, before an issue in a case can be reviewed on appeal.[255]

Review under a writ of mandamus, however, provides a vehicle by which the courts may hear disqualification denials.[256] Mandamus is a writ used to

Services, Inc. v. Morgan, 557 F.2d 110, 117 (7th Cir. 1977) (per curiam) the Seventh Circuit held that no time limits may be imposed. Since then, the Seventh Circuit has questioned, but not altered, this ruling. *See* Union Carbide Corp. v. U.S. Cutting Serv., Inc., 782 F.2d 710, 716 (7th Cir. 1986) (*Morgan* decision repeatedly questioned, recently undermined by court of appeals; reconsideration unnecessary here). Several courts have rejected the *Morgan* analysis and imposed a timeliness requirement on § 455. *See* Chitimacha Tribe v. Harry L. Laws Co., 690 F.2d 1157, 1164 n.3 (5th Cir. 1982) (§§ 144 and 455 both require timely motion), *cert. denied*, 464 U.S. 814 (1983); *In re* International Business Machs. Corp., 618 F.2d 923, 932 (2d Cir. 1980) (court can impose timeliness requirement despite lack of statutory provision). Timeliness may also be encouraged by treating failure to move for disqualification at an appropriate moment as an implicit waiver, as the Third Circuit did in United States v. Nobel, 696 F.2d 231, 237 (3d Cir. 1982), *cert. denied*, 462 U.S. 1118 (1983).

255. 28 U.S.C. § 1291 (1982). A decision is considered final only when it "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." Firestone Tire & Rubber Co. v. Risjord, 449 U.S. 368, 373-74 (1981) (quoting Coopers & Lybrand v. Livesay, 437 U.S. 463, 467 (1978) (quoting Catlin v. United States, 324 U.S. 229, 233 (1945)).

Courts seldom review disqualification issues under the exception to the finality rule provided by federal law, 28 U.S.C. § 1292(b) (1982), which allows review prior to a decision on the merits only in narrowly circumscribed instances. Under § 1292(b), a district judge must certify an order asking for review and the appellate court must agree to hear the appeal. *Id.* The issue in question must involve "a controlling question of law as to which there is substantial grounds for difference of opinion," and where "immediate appeal from the order may materially advance the ultimate termination of the litigation." *Id.*

The certification process is seldom available for a disqualification motion grounded in either § 144, 455(b)(1) or 455(a), since such a motion generally hinges on interpretation of facts and is unlikely to present a question involving a controlling issue of law as to which there is substantial grounds for difference of opinion. *See* 13A C. WRIGHT, A MILLER & E. COOPER, FEDERAL PRACTICE AND PROCEDURE § 3553 at 659 (1984) (§ 1292(b) standard not often met in disqualification decisions).

Reviewed by certification has been employed occasionally. *See, e.g.*, Davis v. Board of School Comm'rs, 517 F.2d 1044, 1047 (5th Cir. 1975) (review allowed under 28 U.S.C. § 1292(b) to determine whether prejudice against attorney disqualifies under § 144), *cert. denied*, 425 U.S. 944 (1976).

Another means for interlocutory review is the collateral order rule, a common law rule that an interlocutory order is immediately appealable if it is "in that small class which finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated." Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 546 (1949). Appellate courts have proved unwilling to exercise this common law doctrine to review disqualification motions. *See, e.g., In re* Corrugated Container Antitrust Litig., 614 F.2d 958, 960-61 (5th Cir.) (disqualification motions not reviewable under collateral order doctrine because fully reviewable on appeal from final judgment), *cert. denied*, 449 U.S. 888 (1980); *accord* United States v. Gregory, 656 F.2d 1132, 1136 (5th Cir. 1981); United States v. Washington, 573 F.2d 1121, 1122 (9th Cir. 1978). *But see* Moore, *supra* note 226, at 862-63 (arguments supporting review for mandamus also support review under collateral order rule; review under collateral order rule preferable because mandamus may impose higher standard).

256. *See, e.g.*, Pepsico, Inc. v. McMillen, 764 F.2d 458, 460 (7th Cir. 1985) (mandamus appropriate where judge fails to step down when required to by § 455(a)); *In re* United States, 666 F.2d 690, 694 (1st Cir. 1981) (mandamus jurisdiction appropriate where issue is judicial disqualification); *In re* International Business Machs. Corp., 618 F.2d 923, 927 (2d Cir. 1980) (court has power to issue writ of mandamus when disqualification has been denied). *See generally* Berger, *The Manda-*

FOIA # 57720 (URTS 16326) Docid: 70105318 Page 389

command an official to perform a specific act that arises from a public duty,[257] or to confine a court to lawful exercise of its prescribed jurisdiction.[258] Issuance of the writ is traditionally limited to extraordinary circumstances,[259] however, and several conditions governing mandamus limit its use for review of disqualification denials and the comprehensiveness of review under the writ.

One limitation on use of the writ of mandamus is that the writ can be used only to "compel an officer to perform a purely ministerial duty."[260] A writ of mandamus may be issued to confine judges to their jurisdictional powers or to compel them to exercise their judicial authority, but it cannot be used to compel action within judicial discretion.[261] Mandamus may be issued, however, where the discretionary duty is limited and the official has abused that discretion by transgressing those limits.[262]

"Abuse of discretion" is the standard of review that is generally applied to section 455 motions on appeal.[263] Thus, this requirement of mandamus raises questions, which are also present in post-trial review of disqualification denials, regarding the amount of discretion judges actually have over disqualification and what constitutes abuse of this discretion. If the judge's discretion is limited, review is possible under a writ of mandamus and more comprehensive at any stage.

Establishment of abuse of discretion as the standard of review for section 455 decisions occurred prior to the 1974 decision when disqualification was completely discretionary.[264] When Congress revised section 455, it made disqualification mandatory, rather than discretionary, when a reasonable person would question the judge's impartiality.[265] Yet the House of Representatives' commentary on the revised bill suggested that section 455 decisions would continue to be reviewed under the abuse of discretion standard.[266] The House report stated that "[t]he issue of disqualification is a sensitive question of assessing all the facts and circumstances in order to determine whether the failure to disqualify was an abuse of sound judicial discretion."[267]

On the basis of the House report, appellate courts generally have applied the abuse of discretion standard to section 455 questions with little consideration of what discretion the district court should exercise.[268] Occasionally, appellate courts have displayed discomfort with broad discretion by focusing on the substantive issue in a case, thoroughly evaluating the evidence, independently assessing reasonableness, and stating their conclusions without any reference to abuse of discretion.[269]

Recently, the Seventh Circuit directly questioned the abuse of discretion standard in *United States v. Balistrieri*,[270] and rejected it as an inappropriate standard for appellate evaluation of section 455(b)(1) decisions.[271] The court held that review of a disqualification denial should not be deferential because a disqualification motion "puts into issue the integrity of the court's judgment" and places adjudicators in the role of judges of their own cause.[272]

The *Balistrieri* court's position has appeal because it addresses the most troublesome aspect of the disqualification process, the requirement that a judge under attack make an "objective" assessment of his personal, emotional involvement. In addition, the *Balistrieri* court's position rests on the argument frequently used to support mandamus jurisdiction—the responsibility of the courts of appeals to supervise and maintain the integrity of the judicial system.[273] The court did not, however, address the fact that plenary review of disqualification is in conflict with the congressional commentary on the standard of review,[274] and contrary to the general practice of the courts.[275]

Although the position taken by the *Balistrieri* court is extreme, consideration of the congressional statement in context suggests that appellate courts should not be wholly deferential to district court judges who have denied a disqualification motion. The House Report called on appellate courts to assess "all the facts and circumstances" of a disqualification issue at the same time that it

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mus Power of the United States Courts of Appeals: A Complex and Confused Means of Appellate Control, 31 BUFF. L. REV. 37 (1982). *See also* Moore, *supra* note 221, at 839-54 (analysis of mandamus review of disqualification denials).

257. Work v. United States *ex rel.* Rives, 267 U.S. 175, 177 (1925).

258. Roche v. Evaporated Milk Ass'n, 319 U.S. 21, 26 (1943). Courts have the power to issue writs of mandamus under a statutory provision which allows courts to "issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law." 28 U.S.C. § 1651(a) (1982).

259. Will v. United States, 389 U.S. 90, 95 (1967).

260. *Work*, 267 U.S. at 177.

261. *Roche*, 319 U.S. at 27. *See also* Moore, *supra* note 221, at 842-43 (analysis of use of mandamus to direct judges).

262. La Buy v. Howes Leather Co., 352 U.S. 249, 257 (1957); *Work*, 267 U.S. at 177-78.

263. *See* United States v. Harrelson, 754 F.2d 1153, 1165 (5th Cir.) (disqualification decision committed to sound discretion of trial judge; denial of disqualification will be overturned only if discretion is abused); *cert. denied*, 106 S. Ct. 599 (1985); United States v. Nobel, 696 F.2d 231, 234 (3rd Cir. 1982) (accepted standard for review of disqualification denial is abuse of discretion), *cert. denied*, 462 U.S. 1118 (1983); *accord In re* Ibrahim Khan, 751 F.2d 162, 165 (6th Cir. 1984); *In re* Federal Skywalk Cases, 680 F.2d 1175, 1183 (8th Cir.), *cert. denied*, 459 U.S. 988 (1982).

264. Act of June 25, 1948, ch. 646, § 455, 62 Stat. 908. *See supra* note 28 for text of this predecessor section.

265. 28 U.S.C. § 455(a). *See supra* note 12 for text of § 455(a).

266. *House Report*, *supra* note 4, at 6355.

267. *Id.*

268. *See infra* notes 270-75 and accompanying text for cases applying abuse of discretion standard.

269. *See, e.g.*, McKenzie Constr., Inc. v. Maynard, 758 F.2d 97, 100 (3d Cir. 1985) (scrutiny of record, which yielded no evidence of bias, decisive factor in upholding decision); United States v. Porter, 701 F.2d 1158, 1166 (6th Cir.) (court's scrutiny of record showed no evidence of personal prejudice), *cert. denied*, 464 U.S. 1007 (1983).

270. 779 F.2d 1191 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 1490 (1986).

271. 779 F.2d at 1203. The court did not review the motion on the basis of § 455(a); it held that this section could not be raised on post-trial review. *Id.* at 1205.

272. *Id.* at 1203.

273. *Id.* at 1203.

274. *See infra* notes 276-77 and accompanying text for the House statement on the standard of review.

275. The *Balistrieri* decision cited no cases in support of its holding. *See Balistrieri*, 779 F.2d at 1202-03. Other courts have consistently applied the abuse of discretion standard. *See* United States v. Nobel, 696 F.2d 231, 234 (3d Cir. 1982) (abuse of discretion is accepted standard), *cert. denied*, 462 U.S. 1118 (1983).

FOIA # 57720 (URTS 16326) Doc: 70105318 Page 390

referred to "sound judicial discretion,"[276] thus suggesting that the court's review should be comprehensive. Furthermore, Congress severely constricted judicial discretion over disqualification in revising section 455. This is evidenced by the fact that there is no discretion if the circumstances of a case fit within one of the categories in section 455(b), which mandates disqualification without exception.[277] Although judges have some discretion in their evaluation of the evidence under the objective standard of section 455(a), their evaluation is limited by the low threshold of proof set by Congress and by guidelines set by the appellate courts.[278] Moreover, when reasonable grounds for disqualification exist disqualification is mandatory.[279] The discretion of the district court is thus narrowly circumscribed and subject to the supervision of the courts of appeals.

Other limitations on issuance of the writ of mandamus restrict its availability. One limitation is that the writ is generally not available when appeal from final judgment provides an adequate remedy.[280] The Fifth Circuit has denied the writ on the grounds that appeal provided an adequate remedy for failure to disqualify.[281] The majority of courts have held, however, that review of disqualification denials prior to final judgment is critical to the judicial system, if not to the litigant.[282]

A more significant barrier to obtaining disqualification by means of a writ of mandamus is that litigants are required to show that their right to issuance of the writ is "clear and indisputable."[283] It is possible to interpret this requirement as necessitating no more than a finding of abuse of discretion.[284] But the

276. *House Report*, *supra* note 4, at 6355.

277. 28 U.S.C. § 455(b) & (e).

278. *See supra* notes 222-33 and accompanying text for a discussion of the decision-making process for disqualification determinations under section 455(a).

279. 28 U.S.C. § 455(a).

280. Kerr v. United States Dist. Ct., 426 U.S. 394, 403 (1976).

281. *In re* Corrugated Container Antitrust Litig., 614 F.2d 958, 962 (5th Cir.), *cert. denied*, 449 U.S. 888 (1980). The *Corrugated Container* court also considered the merits of the claim for disqualification, 614 F.2d at 963-68, and refused to issue a writ on the merits. *Id.* at 968. The court apparently modified its position later. *See* United States v. Gregory, 656 F.2d 1132, 1136-37 (5th Cir. 1981) (Fifth Circuit followed *Corrugated Container* in holding that review not available under collateral order rule because claim was reviewable on appeal; ignored this argument in considering whether to issue a writ of mandamus).

282. *See In re* United States, 666 F.2d 690, 694 (1st Cir. 1981) (public confidence in judiciary requires that substantial claim of bias be addressed at earliest possible opportunity) (citing *In re* Union Leader Corp., 292 F.2d 381, 384 (1st Cir.), *cert. denied*, 368 U.S. 927 (1961)); *In re* International Business Machs. Corp., 618 F.2d 923, 927 (2d Cir. 1980) (intolerable to judicial system to delay consideration of disqualification denial to final appeal).

The Seventh Circuit has settled the issue of whether appeal provides an adequate remedy by denying the post-trial appealability of § 455(a) disqualification motions and making mandamus the only remedy. United States v. Balistrieri, 779 F.2d 1191, 1205 (7th Cir. 1985), *cert. denied*, 106 U.S. 1490 (1986).

283. Bankers Life and Casualty Co. v. Holland, 346 U.S. 379, 384 (1953); *see also* United States v. Gregory, 656 F.2d 1132, 1136 (5th Cir. 1981) (question of disqualification reviewable on mandamus but party seeking writ must prove "clear and indisputable right" to writ).

284. *See* La Buy v. Howes Leather Co., 352 U.S. 256, 257 (1957) (writ granted where judge clearly abused discretion in referring case to master); Pepsico, Inc. v. McMillen, 764 F.2d 458, 461

need to show a clear and indisputable right has also been interpreted as imposing a higher standard of review.[285] Following disqualification denials, courts of appeals generally require a non-frivolous claim for disqualification[286] and require that bias be "clearly and indisputably" established.[287]

The limited scope of discretion in disqualification decisions and the courts' general interpretation of mandamus requirements suggest that limitations on mandamus do not preclude interlocutory review of disqualification motions in federal courts. Courts have, in fact, advocated liberal interpretation of their powers of review under the writ in disqualification matters as a measure essential to preserving the integrity of the court.[288] Actual disqualification by means of the writ is subject to the clear and indisputable right requirement, however. Thus the writ can be used to correct clearly wrongful refusals but it may not be available for routine review. As a result, mandamus review cannot be relied on to ensure the participation of an adjudicator other than the challenged judge in the disqualification decision.

CONCLUSION

The goals of fairness and public confidence in the judiciary are not fully met by current disqualification practices. Mandamus provides a means for courts of appeals to supervise and set standards for clear abuse of discretion, but it does not provide for the routine involvement of an independent adjudicator in the disqualification process.[289] To make objective disqualification more meaningful, Congress should act either to amend section 455 to provide for transfer of the disqualification motion to another adjudicator at the district court level[290] or provide for immediate and comprehensive appellate review of disqualification denials without the restrictions imposed on review under the writ of mandamus.[291]

(7th Cir. 1985) (writ granted to disqualify judge in circumstances where reasonable people could disagree whether disqualification was mandated).

285. Will v. Calvert Fire Ins. Co., 437 U.S. 655, 665-66 & n.7 (1978) (mere showing of abuse of discretion not sufficient for issuance of writ of mandamus) (Rehnquist, J.) (plurality opinion).

286. *In re* United States, 666 F.2d at 694. *See also* Union Carbide Corp. v. U.S. Cutting Serv., Inc., 782 F.2d 710, 712 (7th Cir. 1986) (writ will be denied in frivolous and even routine cases).

287. *In re* International Business Machs. Corp., 618 F.2d at 934. The clear and indisputable right requirement arguably puts a higher burden on the litigants seeking mandamus than on those seeking final review and leaves open the possibility that the issue could be raised again on final review. Moore, *supra* note 226, at 854 & n.154 & 155.

288. *See* Union Carbide Corp. v. United States Cutting Serv., Inc., 782 F.2d 710, 712 (7th Cir. 1986) (refusal to disqualify in the face of a substantial challenge casts shadow over individual litigation and over integrity of federal judicial process which should be dispelled as soon as possible by authoritative judgment; therefore, court should be liberal in use of writ of mandamus to insure timely review).

289. *See supra* notes 256-62 for a discussion of the use of a writ of mandamus to assure the integrity of the disqualification process.

290. *See supra* notes 246-50 for a discussion of the proposed transfer of the disqualification decision to an adjudicator other than the challenged judge.

291. *See supra* notes 251-55 for a discussion of the proposal for immediate and comprehensiv appellate review of a disqualification motion.

FOIA # 57720 (URTS 16326) DocId: 70 318 Page 391

In addition to congressional action to ensure independent adjudic
disqualification issues, realization of the goals of judicial disqualification
the commitment of the courts. Congress struck a balance when it rev
tion 455 and decided that, despite the burdens disqualification imposed,
be mandated where a judge's impartiality might reasonably be questio
Congress has appropriately left to the courts the responsibility of interp
this standard. The courts, however, have not always held fast to the obje
Congress established.[293] Instead, courts have avoided the burden of disqua
tion by failing to focus on the congressionally mandated objective standar
by showing deference at the appellate level to the decisions of the chall
judges. One circuit has gone so far as to impose the requirement of a high
dard of proof of bias as a prerequisite to post-trial review.[294]

To establish the proper balance, courts of appeals should reexamin
restrictions they have placed on disqualification. As supervisors of the d
courts, they should use the available review procedures to set forth more ex
guidelines for disqualification based on an objective standard and thus hold
trict court judges to the appropriate high level of accountability.

Susan B. Hoe

292. *See supra* note 57, notes 93-97 and note 108 and accompanying text for a discussion of
balance struck by Congress in § 455(a).

293. *See supra* notes 109-241 and accompanying text for a copy of judicial interpretation
application of § 455(a).

294. *See supra* notes 76-100 for a discussion of the Seventh Circuit's opinion in United State
Balistrieri, 779 F.2d 1191 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 1490 (1986).

FOIA # 57201URTS 16326) DOC 0105318 Page 392

NOTES

ANTITRUST LAW—A Relaxed Application of the State Action Doctrine—*Southern 42nd Street Theater Corp. v. Nederlander Organization, Inc.*, 790 F.2d 1032 (2d Cir. 1986).

INTRODUCTION

In a line of cases beginning in 1943, the United States Supreme Court developed a doctrine that exempts certain state action from the operation of the federal antitrust laws.[1] In the seminal case of *Parker v. Brown*,[2] the Supreme Court held that Congress did not intend that the Sherman Antitrust Act[3] ("Sherman Act") should apply to sovereign state action.[4] Similarly, the Court recognized a "state action defense" in a series of cases involving anticompetitive conduct by state supreme courts,[5] state agencies,[6] municipalities,[7] and private parties[8] who

1. *See infra* notes 87-153 and accompanying text for a discussion of the development of the state action doctrine.

"The word 'exemption' is commonly used by courts as a shorthand expression for [the holding in Parker v. Brown] that the Sherman Antitrust Act was not intended by Congress to prohibit [anticompetitive restraints imposed by states]." City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389, 393 n.8 (1978).

2. 317 U.S. 341 (1943).

3. 15 U.S.C. §§ 1-7 (1982). The Sherman Antitrust Act prohibits "[e]very contract, combination . . . , or conspiracy, in restraint of trade or commerce among the several States . . ." *Id.* § 1. The purpose of the Clayton Antitrust Act, ch. 323, 38 Stat. 730 (1914) (codified as amended at 15 U.S.C. §§ 12-27 (1982 & Supp. III 1985)), enacted as a supplement to the Sherman Act, is to prevent acquisitions when "the effect of such acquisition may be to substantially lessen competition, or tend to create a monopoly." 15 U.S.C. § 18 (1982).

4. 317 U.S. at 352. *See infra* notes 87-92 and accompanying text for a discussion of the *Parker* decision.

5. *See* Hoover v. Ronwin, 466 U.S. 558, 582 (1984) (state supreme court immune from antitrust liability for regulating admission to the bar); Bates v. State Bar, 433 U.S. 350, 363 (1977) (state supreme court immune from antitrust liability for regulating attorney advertisng); Goldfarb v. Virginia State Bar, 421 U.S. 773, 788-89 (1975) (state supreme court immune from antitrust liability for regulating attorney fee schedules).

6. *See* Southern Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48, 65 (1985) (state agency immune from antitrust liability for regulating carrier rates); California Liquor Dealers Ass'n v. Midcal Aluminum, 445 U.S. 97, 106 (1980) (state agency not immune from antitrust liability for regulating liquor resale prices); New Motor Vehicle Bd. v. Orrin W. Fox Co., 439 U.S. 96, 97 (1978) (state agency immune from antitrust liability for regulating automobile manufacturers).

7. *See* Town of Hallie v. City of Eau Claire, 471 U.S. 34, 47 (1985) (municipality operating in competition with neighboring towns protected by antitrust state action exemption); Community Communications Co. v. City of Boulder, 455 U.S. 40, 55 (1982) (municipality regulating cable television under Home Rule not protected from antitrust laws); City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389, 408 (1978) (municipality operating utility in competition with investor-owned utility subject to antitrust laws).

Plumer analysis involves a determination as to whether a rule is substantive or procedural.

For the constitutional provision for a federal court system (augmented by the necessary and proper clause) carries with it congressional power to make rules governing the practice and pleading in those courts, which in turn includes a power to regulate matters which, though falling within the uncertain area between substance and procedure, are rationally capable of classification as either.

Hanna v. Plumer, 380 U.S. at 472, 85 S.Ct. at 1144. Plaintiffs in this case make no showing that the classification of Rule 81(c) as procedural is not rationally based and this Court finds no basis upon which to so hold.

Accordingly, it is ORDERED that Plaintiffs' Motion for Jury Trial be, and is hereby, DENIED.

So ORDERED.

Erie R.R. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938), and that the better approach to this problem is to adhere to *Hanna* and its progeny rather than to enter the "uncertain area between substance and procedure...." *Hanna*, 380 U.S. at 472, 85 S.Ct. at 1144.

THE DELICATE DICHOTOMIES OF JUDICIAL ETHICS

by

CHIEF JUDGE HOWARD T. MARKEY

"Judicial Ethics" has become a growth industry. Dean McKay has pointed out that "The ethical expectations of the public have risen more rapidly than the perception of judges of what is expected of them." In 1960 there were five literary articles published on judicial ethics. In 1975, there were thirty. Congress has enacted "The Judicial Councils Reform and Judicial Conduct and Disability Act of 1980," (Discipline Act) establishing a mechanism for receiving and acting on complaints of judicial misconduct. Congress also passed the "Ethics in Government Act," over-named because it requires only that judges and others publicly disclose their financial status and that of their families once a year. The Judicial Conference of the United States has adopted a "Code of Judicial Conduct for United States Judges," (App. A) and has charged an Advisory Committee of thirteen judges with the triple task of advising inquiring individual judges on ethical questions, publishing opinions on ethics for guidance of all judges, and recommending changes in the Code to the Conference. Many states have established similar advisory bodies.

An expanded, and expanding, public interest in judicial ethics should surprise no one. The federal judiciary is currently at the height of its power and influence. Federal judges not only send people to jail, and make people pay large sums, and decide disputes between A and B—they tell whole classes of people, and cities, and states, and presidents, what they can and cannot do—and they do that almost every day.

It is important to federal judges as well that the public look at judicial ethics and be satisfied with what it sees. It is a requirement absolute that federal judges enjoy a reputation for adherence to the highest ethical standards, for that is the bedrock of their power and influence. Without it they would be impotent. As we all know, the judiciary has no armies. Its ability to render justice, to protect the people's liberties against abuse by any group and by the other branches of government, to cement the public's adherence to the law—all depend on its lifeblood: respect for its moral authority, the only authority it has.

That respect must be earned. It doesn't come with the title, "Judge," or with "Your Honor," or with the robe, or with the Bench, which are but its symbols, important and necessary, but symbols nonetheless. Respect cannot, of course, be ordered, bought, or assumed. It cannot for long be simply granted. Respect must be—and can only be—earned.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 393

Neither is it surprising that every judicial misstep, apparent or real, makes headlines. Nor is that practice all bad. Judges who object should ask themselves whether they would want a federal judiciary in which judicial misconduct was so commonplace as not to be newsworthy. Of course it is sad that, when our burgeoning communications enable the peccadillos of one judge to be seen by millions on TV, the American public's tendency to generalize results in a nationwide tarnishing of the judicial image. That tendency, plus the advent and growth of the investigative reporting phenomenon—reporting only failures, never triumphs—makes the smallest apparent anthill of judicial misconduct a mountain to be climbed by other judges in earning respect for the judiciary. An outstanding judge was denied elevation on the expressed ground that he had reflected an insensitivity to general ethical considerations, by participating in a case in which his family financial interest may have been at least minimally involved. In-house publications, like "Judicature," "The Judges' Journal," and the American and Federal Bar Journals, have periodically carried articles on judicial ethics. The ferment proves the prescience of the Commentary to Canon 2 of the Code of Judicial Conduct in its warning that judges should expect to be "the subject of constant public scrutiny."

The widespread, intense interest in the conduct of judges has many causes, among them the expanded judicial role in the affairs of the people described above, the Justice Fortas affair, and the Watergate syndrome. With "U.S. News and World Report" reporting that 26,000,000 law suits were filed in this country last year, a disinterest in judicial ethics would be impossible. Whatever the cause, however, that increased interest in itself is all to the good. Sunlight can be a great cure. What may be coming clear now, after the early forays, is that some actions taken toward assured saintliness may have been excessive. The aftermath of Watergate may have led to a spasm reaction, unrecognized as such at the time. Improperly handled, sunlight can produce cancer. Hence it was a happy election of The Roscoe Pound—American Trial Lawyers Foundation to address at its 1982 Earl Warren Conference the *issues* associated with "Ethics in Government." The subject is seen as particularly apt when one recalls that Chief Justice Warren, like the present Chief Justice, took a strong personal interest in the ethics of Bench and Bar.

It would be comforting, but unrealistic, to suppose that ethical conduct of judges is a subject without issues. Ethical principles, like all true principles, may themselves be unchallengeable. It is in their application to specific conduct that discomforting issues are present. The need for value trade-offs, mostly unforeseen when ethical codes and statutes were being adopted, arises when the judge confronts a match-up of an ethical principle or a Code provision with contemplated conduct. It would be nice to think that promulgation of Codes and Statutes, and expected, rigid adherence thereto by all judges all the time, would solve the problem. It would be easy, in responding to a judge's "can I ethically do this?" to merely read a code or statute and always say "No." In a

pluralistic, complex society, with numerous competing interests and values, that easy course is rarely open. There are too many delicate dichotomies.

I do not, of course, speak for the federal judiciary, or for the Advisory Committee. My purpose here is to describe, in general and nonexhaustive terms, some of the delicate dichotomies present in considering the ethics of the Judicial branch of government. Others will surely occur to the reader. The conflict content of some may be seen as either greater or less than that envisaged here. In all events, solutions appear needed to problems represented by at least some of the troubling choices outlined.

INDEPENDENCE v. ACCOUNTABILITY

Federal judges are constitutionally appointed to serve "during good behavior." The practical effect of that provision in Article III is that federal judges, absent an impeachable offense, may hold their office "for life."

That the constitutional provision serves as a protection of the people, not the judges, was recognized in *Bradley v. Fisher.*[1] Nonetheless, the presumed inability of "the system" to deal with judicial misconduct short of that warranting impeachment, and the impracticalities attending the impeachment process, have led some to question the wisdom of appointing federal judges "for life." Historically, the questioning has surfaced when judicial decisions have displeased a fair segment of the public and its political representatives, leading often to suggestions that federal judges be subject to reappointment every 10 or 12 years. That dislike for decisions phenomenon, thought by some to be alive today, and to the extent that it seeks to control judicial decisionmaking, constitutes perhaps the greatest threat to the constitutional principle of judicial independence, for it appears directed at the very purpose of the principle.

It is too easy to say judges should be independent in decisionmaking but accountable for the ethics of every other activity in their lives, and stop there. It may well be true in principle. It can be very difficult in application. One must define terms. Accountable to whom? Under what sanctions? Does "accountable" mean "removable" for less than an impeachable offense?

The present-day question is not, or should not be, whether judicial accountability requires creation of an alternative to impeachment as a means of removing judges from office. The real question is, or should be, whether accountability for misconduct or unfitness can be achieved by other means. That effort is not aided when the "independence" of federal judges is equated with a blanket, absolute, "unaccountability." Interestingly, the equation appears in the approach made by supporters and opponents of judicial independence.

1. 80 U.S. (13 Wall) 335 at 349–50, 20 L.Ed. 646.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 394

Though directed at preserving limitation of removal to the established impeachment process, Judge Irving R. Kaufman's perceptive article, "Chilling Judicial Independence" [2] encompasses the view that making judges accountable, even to their judicial peers and for non-impeachable conduct, would so chip away at independence as to warrant rejection of even that limited accountability. Beyond validity of the attribution, it is at least possible to conceive of circumstances under which a judge who had been "disciplined" (short of removal) by his or her colleagues might thereafter feel fear of consequences in decisionmaking. Judge Kaufman makes that point directly in "The Essence of Judicial Independence." [3] Unfortunately, ad hominem derogations of their colleagues' decisions appearing in dissents and concurrences lend credence to the view that judges could (though there is no evidence they ever have) equate "bad" decisionmaking with "bad" conduct warranting some form of "discipline."

Some judges—happily few—nay, very few—whose peccadillos have graced the front page have either stated or implied that no person, body, or institution (other than Congress by impeachment) has a right even to question their conduct, however egregious that conduct may have been. At the moment, the press reports an indicted federal judge as maintaining that he cannot be indicted or tried for a crime until *after* he has been impeached by the House and convicted by the Senate (an approach that does not appear to have occurred to Judges Kerner and Manton, the former resigning his office after conviction, the latter just before trial, or to readers of *United States v. Isaacs.*[4])

The equating of unaccountability with independence by supporters of judicial independence is joined by its opponents, who find unaccountability an easier target, and who often take it another step by equating unaccountability with unelectability. Only by rendering judges "accountable" to the public through the electoral process, say these opponents, can judges be made to correlate their decisions and their conduct with "current societal mores." It does not appear to have occurred to those particular opponents that judges were made to correlate their decisions with current societal mores in Hitler's Germany, as well as in King George's England.

Lest it be thought that no judge sees accommodation possible between maintenance of the constitutional independence of federal judges and creation of a mechanism for their accountability, Chief Judge Edward D. Re published his "Judicial Independence and Accountability: The Judicial Councils Reform and Judicial Conduct and Disability Act of 1980." [5] In that article, Judge Re opposes the views expressed by Judge Kaufman in "The Essence of Judicial Independence," supporting what he sees in the Act as a clear separation of independence and accountability, and pointing up the need for both in our modern, complex democracy.

2. 88 Yale L.J. 681 (1979).

3. 80 Colum.L.Rev. 671 (1980).

4. 493 F.2d 1124 (7th Cir.1974).

5. 8 N.Kentucky L.Rev. 221 (1981).

Ethical considerations come into play, in the independence-accountability dichotomy, in a variety of ways. Almost, if not all, "violations" of the Code of Conduct for Federal Judges are grist for the mill of "accountability" advocates. Obviously, a judge considered totally unaccountable for his or her conduct, except perhaps to God and history, would have neither need for nor interest in any ethical code or guidance. On the other hand, a judge worthy of canonization would so instinctively conform his or her conduct at all times to the highest of ethical principles as to require no ethical code or guidance. Fact is, of course, that judges are human and thus fallible beings. As such, they are subject to the same temptations toward insensitivity, arrogance, concupiscence, greed, pride, inattentiveness-to-all-but-work, and the like, that have plagued mankind since Adam's day.

That judges have adopted a Code and have established and are continuously using an advisory process, and that Congress in the Discipline Act has provided, with formal acquiescence of the judicial branch, a mechanism for public complaints of judicial misconduct, speak well for the notion that judges are presently holding themselves "accountable" for their conduct outside or separate from their decisionmaking. Though there is no method for removing a federal judge for unethical behavior short of that warranting impeachment, the Discipline Act does provide for public complaint and action by judicial councils against such behavior. In this sense, the Act is designed to spotlight accountability of judges for their ethics, and, at the same time, to preserve the independence and autonomy of the judiciary. The question comes on whether judicial compliance with procedures under the Act (App. B), will supply sufficient accountability, and be sufficiently seen as doing so, to destroy what is now seen by some as a dichotomy between judicial independence and judicial accountability.

ISOLATION v. INVOLVEMENT

In a seeming paradox, the American public is currently and simultaneously demanding (1) that judges through their judging get more and more involved in the management of society; and (2) that judges, when they are not judging, be more and more isolated from society.

The demand for increased judicial imposition has stemmed in part from frustration with what is viewed as legislative and executive failures to act, as well as from statutes establishing broad societal goals, giving government agencies broad authority to act toward those goals, and creating new causes of action in favor of anyone dissatisfied with agency action. That is not to say that all judges have been dragged kicking and screaming into the social management morass. Some have. Others have cheerfully rushed in, out of a compelling sense of duty to decide and a perceived call to render justice.

The demand for isolation is not so described, but is inherent in the increased interest in the ethical conduct of judges engendered by post-Watergate disenchantment with officialdom in general and from highly

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 395

publicized incidents of apparent misconduct by three federal and three or four state judges. That the numbers are small is not a compelling argument against a demand for ethical conduct and guideline codes to serve as aids in defining that conduct. The small-number factor does, however, raise a caveat concerning the value trade-off involved in the isolation of judges. Query: If total isolation of all judges from all societal contact off the Bench would guarantee a totally ethical judiciary, what would be the cost?

The increased involvement of judges in the management of society's affairs through judicial decisions is not the involvement intended for discussion here. The current reaction to what is viewed in some quarters as "judicial activism" and "the imperial judiciary" will in time work toward some semblance of balance in measuring the roles of our judicial, legislative, and executive branches of government.

The involvement intended for discussion here is that of the individual judge and his family as persons in the everyday affairs of the community. It is from that arena that ethical considerations have served, and are serving, to isolate federal judges. The dichotomy arises from the felt need of judges for familiarity with the affairs of men and women beyond that gleanable from TV and newspapers, and insofar as that familiarity would assist in decisionmaking. Judges in their judging must on occasion ignore public clamor, current fads, and what may be asserted by vociferous groups to be "modern societal mores." To do that they must be independent. But that is not to say that judges should be attempting to interpret and apply the law to a society of strangers. Absent some fair level of familiarity, the language and thrust of judicial decisions could appear to be so far ahead or behind the march of society as to cause the people to be "turned off," to cause the people to simply disregard judicial decisions because they seem just too "far out." It is unlikely, for example, that the people would, or with safety could, put all their eggs in a judicial basket carried by a man or woman from outer space, or newly arrived from outer Mongolia. The example emphasizes with exaggeration, but not too much, for most of the Canons in the Code of Conduct for Federal Judges deal with and tend to limit the involvement of the judge as a person in community affairs. Further, the opinions published by the Advisory Committee of the Judicial Conference have supplied similarly limiting interpretation and applications of the Code.

Under the Code, the Commentaries to the Code, and the published Advisory Opinions, for example, a federal judge should not:

1. Do anything that may interfere with performance of his or her judicial duties.
2. Do anything that may enable others, or appear to enable others, to exploit his or her judicial position.
3. Volunteer as a character witness.
4. Initiate recommendations of others for appointment, promotion, parole, admission to school, etc.

5. Join certain types of clubs.
6. Do any fund raising of any kind for any organization or purpose whatsoever.
7. Join any organization that is a potential litigant or financer of litigation.
8. Increase the bases for disqualification by associating with former partners and lawyer-friends, or by making certain investments.
9. Sit in a case in which his or her impartiality might "reasonably be questioned," and shall absolutely not sit when any one of some 14 specific circumstances exist.
10. Advise a trustee of a family estate on investments, unless the judge had a close familial relationship with the deceased.
11. Testify on legislation as a citizen. Testimony as a judge and on legislation dealing with the courts and administration of justice is alone permissible.
12. Speak, be a guest of honor, or accept an award, at any fund raising event.
13. Engage in financial or business dealings with lawyers or persons likely to come before his or her court.
14. Serve as officer, director, partner, manager, advisor, or employee of a business or corporation.
15. Accept any gift, favor, or loan, except under specified, very limited circumstances.
16. Serve as executor, administrator, trustee, or guardian of any trust or estate, except that of a family member, and then only if the trust or estate is not likely to come before the judge.
17. Act as arbitrator or mediator, or practice law, or accept appointment to a non-judicial governmental committee or commission, local, state, or federal.
18. Advise any member of the legislative or executive branches on any subject.
19. Serve on the board of a community legal aid bureau.
20. Serve as co-trustee of a pension trust.
21. Fail to report to the public all of his or her income and investments and those of the judge's family.
22. Lead or hold office in any political organization, local, state, or federal.
23. Speak for or endorse any political candidate.
24. Contribute money to any political organization or candidate.
25. Attend or buy tickets for political gatherings.
26. Run for political office without first resigning his or her judicial office.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 396

27. Fail to caution a spouse against appearance of involvement of the judge in the spouse's political activities.
28. Lunch once a year at a political club.
29. Serve as counsel to a local United Way charity.
30. Hire as law clerk the child of another judge of the court.
31. Attend an educational seminar financed by frequently litigating corporations.

The foregoing list is by no means exhaustive. The list of "no-no's" would grow beyond the limits of this short paper if it were to include the advice given in confidence to the hundreds of judges who have submitted specific inquiries to the Advisory Committee, which publishes its opinions only in relation to repetitive situations likely to be encountered by most or all judges. The list appears of sufficient length and breadth, however, to warrant discussion of the isolation-involvement dichotomy.

PRESUMPTION OF IMPARTIALITY v. PRESUMPTION OF PARTIALITY

In talking, about five years ago, with a judge of the High Court of England, an American judge exhibited shock when the British judge said his son had argued a case before him. Noting the American's expression, the British judge in turn expressed shock that anyone might even question the impartiality of a judge of the High Court on the mere and sole premise that his son represented one side. The American responded that the same was probably true in the earlier days of his country, but it is true no more.

The view that justice includes the appearance of justice has increasingly gained adherents over the years, until it is now accepted wisdom. The appearance of justice is today seen not as separate from, but as an integral part of justice itself. John P. MacKenzie, now of the New York Times, set forth the rational basis for that view in the clearest terms in his book "The Appearance of Justice." It simply is not enough that justice be actually done. It must be seen to have been done. Our British friend felt free to sit in his son's case precisely because his public would not, apparently, view that event as raising even the possibility that injustice would be done by the judge. On this side of the Atlantic, the public has acquired what some would call a more realistic view of human nature. Others might call the American view jaundiced. In any case, we seem to think it not only possible but probable, if not certain, that a judge sitting in his son's case would either favor his son's client or, because our public is "realistically suspicious," the judge would lean overmuch the other way to avoid an appearance of doing so. It was not always so.

The great Chief Justice Marshall, without quibble or concern, sat on the appeal of decisions he had rendered as trial judge and served a role as Secretary of State in the midnight Judge Scenario that led to his justly famous decision in *Marbury v. Madison*, 1 Cranch 137, 2 L.Ed. 60.

As now documented by Bruce Murphy in "The Brandeis-Frankfurter Connection," those famous and familiar justices of more recent days apparently felt perfectly free to participate up to their elbows in political appointments and political policy-making while on the Bench. That the latter were active in recent times may account for what may have been an attempt to protect the Court, an attempt evidenced by their yeoman efforts to mask their political activities. Though those efforts may indicate that concern for judicial ethics was beginning to be felt in America during and post World War II, that concern was obviously not yet of sufficient strength, or sufficiently widespread, to cause Justices Brandeis and Frankfurter to refrain from or even limit their political activities. Indeed, Murphy ends "Connection" with a quasi-absolution of the two justices on the ground that they had no reason to expect exposure and thus no reason to fear injury to the Court. Given the absence of investigative reporters and widespread public interest in judicial ethics, such an expectation of the justices was reasonable and the cover-up efforts documented in the book were in fact successful at the time.

What may now be seen as a past public faith in American judges may have been something quite different. It may have been mere apathy, aided by lack of communications and minimal contact with the courts as compared with today's litigious society. In any event if it did previously exist here, a public presumption of impartiality cannot be expected to return as part of America's view of its judges. The problem now is to consider whether we are in danger of going, or may have already gone, too far in the direction of a public presumption of partiality.

It is not too much to say that most persons tend to live up, or down, to the reputation given them and to do the expected. There may be something to be said for the proposition that judges should be given at least an initial presumption of rectitude, if not quite the presumption of innocence given those indicted for crimes. Do we run the risk of attracting less than the best to the Bench if we confront them throughout their remaining lives with our expressed expectation that they are likely to act unethically? Is it enough to say that the best would have nothing to fear from that expectation? It may yet be too early to tell, but perhaps a continuing study of the effect of such an expectation on judges' lives, on their self-image, on refusals of the best to accept appointments, and on resignations, would be justified.

Canon 3 C(1) and 28 U.S.C. § 455(a) say, for example, that a judge is disqualified if his or her impartiality might "reasonably" be questioned. What means "reasonably"? 28 U.S.C. § 455(b) says the judge is absolutely disqualified if he or she or a family member in the household has an involved financial interest "however small." Whether it is reasonable to expect that a judge will violate his or her oath of office for ten cents is irrelevant under 28 U.S.C. § 455(b). The irrebuttable presumption of partiality in section (b) thus tends to be carried into applications of the general section (a) and to interpretations of "reasonably" in that section.

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 397

It would, of course, be possible to establish a presumption that judges act honorably and ethically. Certainly the vast majority of judges work daily toward that end. Canon 1 recognizes that it is the conduct of judges that either preserves or destroys the perceived integrity and the continued independence of the judiciary. It does seem unfair, though doubtless inevitable, that "the judiciary," and all its members, are tarnished when one judge goes astray. It seems even more unfair when an individual judge, after twenty-five years of outstanding, totally ethical service, is presumed incapable of rendering justice in a case in which his wife has inherited .00000000012% of the stock of Exxon (an actual case). It may also be unwise, for the taxpayers must arrange to replace that judge in that case, and, multiplied by the hundreds, the time and paperwork costs seem excessive.

Last year, Federal District Judge Muecke was forced by 28 U.S.C. § 455(b) to step aside after years and years of presiding over a complex anti-trust class action, when it was learned that his wife owned a few shares in one of some 2000 corporate parties identified long after the suit was filed. In doing so, he issued a lengthy memorandum opinion outlining what can only be here called the unwisdom of the "however small" provision in section 455(b). He pointed out that a new judge and the parties would have to virtually "start over," down a road already paved with massive expenditures of time and money by the parties and the taxpayers. Having made the calculations, he included in his memorandum a statement that the maximum possible effect on his wife's financial interests could not, under even a worst-case scenario, exceed $4.69!

Because of section 455(b) and the public disclosure of judge-and-family stockholdings required by the "Ethics in Government Act," lawyers are enabled to implead or intervene an applicable corporation, or arrange filing by a corporate *amicus curiae*, at a late stage, should things appear to be going badly before the presiding judge. Because the judge or the judge's family owns stock in that corporation, the lawyers may thereby acquire a new judge and a fresh start. There are no studies and no proofs that this maneuver is yet widespread, but the events in certain cases raise a strong basis for the belief that it has been carried out in some cases, where the stock ownership of the judge and the availability of the right corporation dovetailed. Whether yet widely used, it is obviously available in some cases, and a lawyer's dedication to what is perceived as the client's interest will lead to its use in some of those cases.[6]

The Judicial Conference of the United States has submitted to the Congress a proposed amendment to section 455(b), which would permit a

6. Some judges have simply divested themselves of all stockholdings in corporations, in an effort "to avoid the problem." Others are unable to do so, either because of heavy attendant losses and taxes, or because the stock is owned by a spouse or household family member who declines the invitation to divestment. Query: if no judge or judge's family owned any stock in any American corporation, what would be the effect of that further isolation from society's affairs (in this instance, its economic affairs)?

judge to weigh the public interest present in his decision to step aside or continue with the case. The amendment would apply only in certain limited circumstances. Congress has thus far been too involved with other matters to take any action whatever on the proposal. The proposal is but a tiny inroad on the presumption of partiality inherent in the requirement that a judge recuse himself to avoid being influenced by $4.69. It does not, of course, destroy the dichotomy between presumptions of impartiality and partiality.

Perhaps the move now should be toward such revisions in the Code and Statutes as would tend toward some diminution in the presumption of partiality and at least some slight movement, where feasible, toward a salutory presumption of impartiality.

APPEARANCE v. REALITY

The dichotomy between presumptions of impartiality and partiality exists on a "wholesale" level. At the "retail" level, where individual judges confront specific circumstances, a dichotomy between appearance and reality resides.

As above indicated, the appearance of justice cannot be divorced from justice itself. A corollary has grown up: "the appearance of unethical conduct cannot be divorced from the conduct itself." Perhaps ninety-five percent of the work of the Advisory Committee on Codes of Conduct deals with "appearance" questions. When contemplated conduct is advised against, it is almost always because that conduct could reasonably present to a watching and suspicious public, or to a segment thereof, the appearance of impropriety, or the appearance that the judge may be partial, or may be subject to an influence, or may be advancing the private or political interests of a person or party, or may have made an appointment on a basis other than merit, or may have an interest in the outcome of a case before him. Similarly, when the Committee advises that no ethical impediment precludes the conduct, it is almost invariably because no such appearance is reasonably possible.

In either case, the reality is irrelevant. The question is rarely whether the conduct is itself unethical. Most if not all unethical conduct is rejected out of hand by judges and no inquiry to the Committee is necessary or useful. No doubt a judge knowingly engaged in clearly unethical conduct, if such judge there be, would not be likely to seek the advice of the Committee. The inquiring judge, in most instances has determined that the contemplated conduct would probably be in fact fully ethical, but seeks the Committee's advice respecting the appearance aspect. Similarly, the Committee has often specifically recognized the ethical purity of the conduct in question, while advising against its undertaking because of the appearances that step would create.

Does it matter that judges are precluded from what is otherwise ethical conduct because that conduct might reasonably create an untoward facade or appearance? It does to some judges. In the throes of accepting the code and some of its provisions, some judges, certain of

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 398

their own rectitude, objected to the very concept of a code. That position was variously stated, extending from an assertion that some provisions violated a judge's First Amendment right of free association, to the more common assertion that the code was simply unnecessary, because the conduct of most judges already matched its provisions, and that any expectedly rare infraction could be dealt with on a case-by-case basis. The last was based on a quasi-burden of proof approach, i.e., if someone had any reason to think a particular judge was acting improperly it was up to that person to come forward and assert such charges as were thought appropriate, while the other judges went on acting properly, without codes, advisory opinions, and committees. Recognizing the existence of earlier codes, the burgeoning public interest in the ethics of government officials, including judges, and a need for some guidance, at the very least to aid new judges, the Judicial Conference adopted the present Code in April, 1973.

Though judges have, as above noted, fully accepted the code and advisory system, the notion that, "I know I am doing right. I have been appointed by the President and confirmed by the Senate. Why can't I be trusted?" has not entirely died, particularly among the more experienced judges who add a reference to their years of distinguished and totally ethical service on the Bench. Alongside that notion may be placed the concept, quietly and privately expressed by a tiny minority of small but roughly equal numbers of both experienced and inexperienced judges, that judges should be judged solely on their performance as judges. Holders of the latter concept readily accept guidelines relating to their demeanor in court, their treatment of litigants, counsel and witnesses, their work habits, and in general their approach to the work of judging. To them those are the realities, and the only realities, to which ethical considerations should apply. To them it doesn't matter with whom a judge associates (barring criminals and the like), or which clubs he joins, or whether he sits in a case involving a corporation in which he owns substantial stock or in which his recent partner and continuing good friend appears as counsel. Certain of their ability to judge with integrity and impartiality regardless of circumstances, to comply with their oaths of office even when compliance injures their interests, they find it at least somewhat incongruous for the courts to hold that homosexuality, communist party membership, and similar circumstances do not warrant denial of government employment unless the circumstance affects the person's performance on the job, while judges are assumed to be "incapable" of "doing their job" on the basis of mere appearances.

I hasten to add that even the tiny minority desiring to be judged solely on job performance have accepted the Code and are complying with it. They simply view it as unnecessary and somewhat demeaning.

Those entertaining the "performance on the Bench is all that counts" concept would, in any event, be likely to find few adherents to that concept among other judges and virtually none among today's general public. First, judging is not merely a "job," like plumbing, or carpentering, or whatever. Judges are given the privileged joy of working at the

heartbeat of a free society, the law. They deal daily with society's most precious asset, justice. The property, the liberty, the fortunes, and the very lives of citizens, are often in their hands. In the dichotomy of appearances and realities, the public's current approach to its judges does not permit it to perceive that justice is being done if the public be limited to observation of the performance of the judge qua judge. Few of the public understand the judicial process or are capable of distinguishing the good judge from the poor solely on the quality of his or her judging. For much of the public, appearances are all it has to go by. It is conceivable, for example, that a judge might do an outstanding "job" on the Bench, while appearing drunk in a public bar three nights a week, but few if any of the public would believe it—and the few who might would still prefer that their judges, however good their judicial performance, not be chosen from drunkards. In virtually every instance of reasonably asserted conflict between unethical appearances and ethical realities, appearances must win.

There is, however, some hope for at least a partial resolution of the appearances—realities dichotomy. Passage of the Discipline Act may serve to ameliorate both public and judicial concern for what to some may appear an overemphasis on appearances and an unwarranted disregard of realities. It has the potential for stripping away appearances and unearthing the underlying realities, whatever the latter may be.

The Act expands the powers and duties of the Judicial Councils of the Circuits. It requires the Chief Judge of each circuit to call a meeting of the circuit judicial council at least twice a year. It provides for selection of council members, to include district judges. If the number of circuit judges is less than six, the number of district court judges must be at least two. If the number of circuit judges is more than six, the number of district court judges must be at least three. The council is authorized to hold hearings, receive testimony and issue subpoenas. The Act requires that all judicial officers and employees of the circuit "promptly carry into effect all orders of the judicial council."

Under the Act, "any person" may complain that a circuit or district judge, a bankruptcy judge, or a magistrate "has engaged in conduct prejudicial to the effective and expeditious administration of the business of the courts, or ... that such a judge or magistrate is unable to discharge all the duties of office by reason of mental or physical disability." The complaint must be written and filed with Clerk of the Court of Appeals of the circuit. The complaint is then transmitted by the Clerk to the Chief Judge of the circuit.

The Chief Judge may dismiss those complaints not addressed to conduct prejudicial to the administration of justice or disability, those complaints directed to the merits of a case or a procedural ruling, and those complaints that are clearly frivolous.[7] He may conclude the

7. In the first eighteen months of the Act, very few complaints have been filed, a circumstance due possibly to public unfamiliarity with the Act. The vast majority have been dismissed because they were filed by losing litigants alleging error in the judgment against them.

FOIA # 57720 (URTS 16326) DocId: 7010331 Page 399

proceeding if "appropriate corrective action has been taken" by the Chief Judge.

When the Chief Judge dismisses a complaint, copies of his written order are sent to the complainant and to the judge or magistrate complained against. When the Chief Judge decides that the complaint requires investigation, he appoints himself and other judges to a "special committee to investigate the facts and allegations." To preserve their rights, the judge and complainant are given notice in writing of the committee's actions.

The judicial council receives a "comprehensive written report" of the special committee's investigation and recommendations. The council may then conduct "any additional investigation which it considers to be necessary," and "shall take such action as is appropriate to assure the effective and expeditious administration of the business of the courts." The council may take one or more different actions, including: certifying disability of the judge; requesting voluntary retirement; ordering a temporary halt in assignment of cases to the judge; private or public censure or reprimand; and "such other action as it considers appropriate," except removal from office of an Article III judge. The parties receive written notice of the council's actions.

In more serious cases, the council may refer the complaint and its recommendations to the Judicial Conference of the United States. When the council has determined that a judge's conduct "might constitute grounds for impeachment," the council must refer the matter to the Judicial Conference of the United States. Written notice of a referral to the Conference must be given to the parties "unless contrary to the interests of justice."

The Judicial Conference may take any action takeable by the councils, and may transmit the record to the House of Representatives when impeachment is a possibility.

Complainants, judges, or magistrates aggrieved by final orders of a Chief Judge or a judicial council may petition the judicial council or the Judicial Conference of the United States for review. Denials of such petitions are final, safeguarding the judge from harassment, and binding a sanctioned judge to the decision.

The judicial councils have prescribed procedural rules for carrying out the Act (App. B). The rules guarantee the judge prior written notice of any investigation, and allow the judge to appear at proceedings, present evidence, compel attendance of witnesses and present oral and written evidence and argument. The rules may allow complainants to appear at proceedings "if the panel concludes that the complainant could offer substantial information." The rules are made public record, and available from the Clerk of Court, to facilitate their use by the public.

The act is not intended to establish an adversary procedure. It does not require that the complainant be given a hearing, or the opportunity to cross-examine witnesses. The council investigates the complaint and controls the inquiry as appropriate under the circumstances. The proceeding is intended to be "inquisitorial-administrative" rather than "accusatorial-adversary."

Perhaps the most important provision of the Act is its recognition of the need to preserve judicial independence. By providing a complaint mechanism operated entirely by and within the judiciary, and by specifically denying removal action except by impeachment, the Act makes clear that inroads on judicial independence are not intended.

The Act also seeks to preserve independence of judicial decisionmaking by providing for summary dismissal of complaints directed against judgments and procedural rulings. It has been said that the availability of an appeal from district court judgments, and of petitions for rehearing, rehearing *en banc*, and *certiorari* in relation to appellate court judgments, make redundant the Act's separation of complaints on subject matter properly assertable by appeal or petition. If so, a little redundancy cannot hurt the setting up of this new and potentially sensitive complaint mechanism, particularly when the redundancy is directed toward judicial independence. Moreover, summary dismissal by the circuit Chief Judge frees the judge complained of from the interruption of the judge's judicial work that would occur if the judge were required to review and respond to such complaints.

Like most legislative efforts, the Act is not a panacea. Questions respecting its implementation surfaced almost immediately upon its passage. In "The New Federal Judicial Discipline Act: Some Questions Congress Didn't Answer," [8] Eric Neisser asked numerous questions: What constitutes a council "meeting" and "quorum"? Must the chief judge preside? What are and who sets the terms for council membership? Who chooses the method of selecting council members? Who decides on inability of a council member to serve? What can be done if one refuses to obey a council order? How does the government itself file a complaint? Are anonymous complaints permissible? Are impeachable and criminal offenses proper subjects for this mechanism? What if any time limits are intended by "promptly" and "expeditiously" and how can a complainant confront dilatoriness? Who can serve on an investigating committee and on its staff? Are that committee's findings binding on the council? Can a council impose more than one sanction, or conduct more than one proceeding, for the same Act? How can the requirement for publication of orders be reconciled with the provision for a "private" reprimand? Can or should disciplinary orders be stayed? Who can serve on the Judicial Conference of the United States' standing committee? What rules will be applicable to the review procedure?

Doubtless other questions will arise as the councils gain experience with the Act. Legislative modification may also be indicated. For our purposes here, it is enough to note that one probable effect of procedures under the act is to nudge the public's approach to judicial ethics in the direction of actual realities in specific cases. Appearances will not down, of course, nor should they. A large part of the consideration of a

8. Judicature, Vol. 65, No. 3, September 1981, pp. 142–160.

FOIA # 37201(URTS 16326) DocId: 70105318 Page 400

complaint about specific conduct will be played by the appearances that may have prompted the complaint. Conceivably, a Chief Judge may dismiss a complaint because it does not allege conduct that is in reality "prejudicial to the effective and expeditious administration of the business of the courts," and still privately counsel the complained of judge to avoid whatever appearances may be involved. Perhaps the Act will not raise realities to an entitlement of "equal billing" with appearances, but it can, by spotlighting realities in specific cases, resolve at least part of the appearance—reality dichotomy.

CONCLUSION

I close on a personal note. Having had the inestimable privilege of getting to know many if not most federal judges, through eleven years on the Judicial Conference, through sitting repeatedly with every court of appeals, through committee work, through service on the Judicial Center Faculty, and through phone calls related to the work of the advisory committee, I can report that I have never met an unethical federal judge. That is not to guarantee that none exists. Nor is it to say that I am authorized, qualified or sufficiently informed to assess the ethics of all federal judges or of any one judge. I am not. I have not met the three judges whose names have "made the press" in connection with untoward conduct, but every one of the hundreds of judges I have met impresses me as singularly dedicated to a desire that has haunted his or her dreams since the day the robe was donned—a desire to decide every case correctly, to render equal justice under law to all persons and institutions.

Indeed, I have often said, "No one would ever work as hard as judges do for money!" In the last decade, as is still too little known, the workload of the federal judiciary has quadrupled. With grudging, long-after-the-fact and minimal additions of judges, and long-delayed-but-still-inadequate increases in compensation, the federal judiciary, under the outstanding and innovative administrative leadership of The Chief Justice, has established an edifying record of dedicated, selfless public service. Yeoman in-house efforts have been made to keep up with an ever burgeoning caseload, to develop and adopt new procedures, new staffing, new rules. To consider, modify, disseminate, and adopt new procedures and rules has required devotion of many hours on top of those needed for the pure work of judging in four times the number of cases faced in 1970. It is doubtful that any institution, private or governmental, can point to a finer record of dedicated performance of duty.

Yet, through it all, the federal judiciary has been fully conscious of the requirement that it not only act ethically but that it be seen as acting ethically at all times and under all circumstances. As said at the outset, I speak only for myself, but I am confident that if I were to speak for the entire federal judiciary, I would be authorized to welcome any and all suggestions for even further improvement. The judiciary's door is in my

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 401

view wide open to any and every means by which the American people can be continuously assured that their judicial servants are not only interpreting and applying the law independently and properly, but that they are doing so out of lives lived in accord with the highest ethical standards.

APPENDIX A

CODE OF JUDICIAL CONDUCT FOR UNITED STATES JUDGES

PART I. CODE OF JUDICIAL CONDUCT FOR UNITED STATES JUDGES[1]

CANON 1

A JUDGE SHOULD UPHOLD THE INTEGRITY AND INDEPENDENCE OF THE JUDICIARY

An independent and honorable judiciary is indispensable to justice in our society. A judge should participate in establishing, maintaining, and enforcing, and should himself observe, high standards of conduct so that the integrity and independence of the judiciary may be preserved. The provisions of this Code should be construed and applied to further that objective.

CANON 2

A JUDGE SHOULD AVOID IMPROPRIETY AND THE APPEARANCE OF IMPROPRIETY IN ALL HIS ACTIVITIES

A. A judge should respect and comply with the law and should conduct himself at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary.

B. A judge should not allow his family, social, or other relationships to influence his judicial conduct or judgment. He should not lend the prestige of his office to advance the private interests of others; nor should he convey or permit others to convey the impression that they are in a special position to influence him. He should not testify voluntarily as a character witness.

COMMENTARY

Public confidence in the judiciary is eroded by irresponsible or improper conduct by judges. A judge must avoid all impropriety and appearance of impropriety. He must expect to be the subject of constant public scrutiny. He must therefore accept restrictions on his conduct that might be viewed as burdensome by the ordinary citizen and should do so freely and willingly.

The testimony of a judge as a character witness injects the prestige of his office into the proceeding in which he testifies and may be misunderstood to be an official testimonial. This Canon, however, does not afford him a privilege against testifying in response to an official summons.

The Judicial Conference of the United States has endorsed the principle that it is inappropriate for a judge to hold membership in any organization that practices invidious discrimination. A judge should carefully consider whether the judge's membership in a particular organization might reasonably raise a question of the judge's impartiality in a case

[1] By resolution of the Judicial Conference of the United States this Code has been made applicable to Bankruptcy Judges and to United States Magistrates.

APPENDIX A—Continued

involving issues as to discriminatory treatment of persons on the basis of race, sex, religion, or national origin. The question whether a particular organization practices invidious discrimination is often complex and not capable of being determined from a mere examination of its membership roll. Judges as well as others have rights of privacy and association. Although each judge must always be alert to the question, it must ultimately be determined by the conscience of the individual judge whether membership in a particular organization is incompatible with the duties of the judicial office.

CANON 3

A JUDGE SHOULD PERFORM THE DUTIES OF HIS OFFICE IMPARTIALLY AND DILIGENTLY

The judicial duties of a judge take precedence over all his other activities. His judicial duties include all the duties of his office prescribed by law. In the performance of these duties, the following standards apply:

A. Adjudicative Responsibilities

(1) A judge should be faithful to the law and maintain professional competence in it. He should be unswayed by partisan interests, public clamor, or fear of criticism.

(2) A judge should maintain order and decorum in proceedings before him.

(3) A judge should be patient, dignified, and courteous to litigants, jurors, witnesses, lawyers, and others with whom he deals in his official capacity, and should require similar conduct of lawyers, and of his staff, court officials, and others subject to his direction and control.

COMMENTARY

The duty to hear all proceedings fairly and with patience is not inconsistent with the duty to dispose promptly of the business of the court. Courts can be efficient and businesslike while being patient and deliberate.

(4) A judge should accord to every person who is legally interested in a proceeding, or his lawyer, full right to be heard according to law, and, except as authorized by law, neither initiate nor consider ex-parte or other communications concerning a pending or impending proceeding. A judge, however, may obtain the advice of a disinterested expert on the law applicable to a proceeding before him if he gives notice to the parties of the person consulted and the substance of the advice, and affords the parties reasonable opportunity to respond.

COMMENTARY

The proscription against communications concerning a proceeding includes communications from lawyers, law teachers, and other persons who are not participants in the proceeding, except to the limited extent permitted. It does not preclude a judge from consulting with other judges, or with court personnel whose function is to aid the judge in carrying out his adjudicative responsibilities.

An appropriate and often desirable procedure for a court to obtain the advice of a disinterested expert on legal issues is to invite him to file a brief amicus-curiae.

(5) A judge should dispose promptly of the business of the court.

COMMENTARY

Prompt disposition of the court's business requires a judge to devote adequate time to his duties, to be punctual in attending court and expeditious in determining matters under submission, and to insist that court officials, litigants and their lawyers cooperate with him to that end.

APPENDIX A—Continued

(6) A judge should abstain from public comment about a pending or impending proceeding in any court, and should require similar abstention on the part of court personnel subject to his direction and control. This subsection does not prohibit judges from making public statements in the course of their official duties or from explaining for public information the procedures of the court.

COMMENTARY

"Court personnel" does not include the lawyers in a proceeding before a judge. The conduct of lawyers is governed by DR7–107 of the Code of Professional Responsibility.

(7) A judge should prohibit broadcasting, televising, recording, or taking photographs in the courtroom and areas immediately adjacent thereto during sessions of court or recesses between sessions, except that a judge may authorize:

(a) the use of electronic or photographic means for the presentation of evidence, or for the perpetuation of a record; and

(b) the broadcasting, televising, recording, or photographing of investitive, ceremonial, or naturalization proceedings.

B. Administrative Responsibilities

(1) A judge should diligently discharge his administrative responsibilities, maintain professional competence in judicial administration, and facilitate the performance of the administrative responsibilities of other judges and court officials.

(2) A judge should require his staff and court officials subject to his direction and control to observe the standards of fidelity and diligence that apply to him.

(3) A judge should take or initiate appropriate disciplinary measures against a judge or lawyer for unprofessional conduct of which the judge may become aware.

COMMENTARY

Disciplinary measures may include reporting a lawyer's misconduct to an appropriate disciplinary body.

(4) A judge should not make unnecessary appointments. He should exercise his power of appointment only on the basis of merit, avoiding nepotism and favoritism. He should not approve compensation of appointees beyond the fair value of services rendered.

COMMENTARY

Appointees of the judge include officials such as referees, commissioners, special masters, receivers, guardians, and personnel such as clerks, secretaries, and bailiffs. Consent by the parties to an appointment or an award of compensation does not relieve the judge of the obligation prescribed by this subsection.

C. Disqualification

(1) A judge shall disqualify himself in a proceeding in which his impartiality might reasonably be questioned, including but not limited to instances where:

(a) He has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;

(b) he served as lawyer in the matter in controversy, or a lawyer with whom he previously practiced law served during such association as a lawyer concerning the matter, or the judge or such lawyer has been a material witness concerning it;

(c) he knows that he, individually or as a fiduciary, or his spouse or minor child residing in his household, has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding;

FOIA# 57720 (URTS 16326) DocId: 7010531 Page 102

APPENDIX A—Continued

(d) he or his spouse, or a person within the third degree of relationship to either of them, or the spouse of such a person:

(i) is a party to the proceeding, or an officer, director, or trustee of a party;
(ii) is acting as a lawyer in the proceeding.

COMMENTARY

The fact that a lawyer in a proceeding is affiliated with a law firm with which a lawyer-relative of the judge is affiliated does not of itself disqualify the judge. Under appropriate circumstances, the fact that "his impartiality might reasonably be questioned" under Canon 3C(1), or that the lawyer-relative is known by the judge to have an interest in the law firm that could be "substantially affected by the outcome of the proceeding" under Canon 3C(1)(d)(iii) may require his disqualification.

(iii) is known by the judge to have an interest that could be substantially affected by the outcome of the proceeding;
(iv) is to the judge's knowledge likely to be a material witness in the proceeding;

(e) he has served in governmental employment and in such capacity participated as counsel, advisor, or material witness concerning the proceeding or expressed an opinion concerning the merits of the particular case in controversy.

(2) A judge should inform himself about his personal and fiduciary financial interests, and make a reasonable effort to inform himself about the personal financial interests of his spouse and minor children residing in his household.

(3) For the purposes of this section:

(a) the degree of relationship is calculated according to the civil law system;

COMMENTARY

According to the civil law system, the third degree of relationship test would, for example, disqualify the judge if his or his spouse's father, grandfather, uncle, brother, or niece's husband were a party or lawyer in the proceeding, but would not disqualify him if a cousin were a party or lawyer in the proceeding.

(b) "fiduciary" includes such relationships as executor, administrator, trustee, and guardian;

(c) "financial interest" means ownership of a legal or equitable interest, however small, or a relationship as director, advisor, or other active participant in the affairs of a party, except that:

(i) ownership in a mutual or common investment fund that holds securities is not a "financial interest" in such securities unless the judge participates in the management of the fund;
(ii) an office in an educational, religious, charitable, fraternal, or civic organization is not a "financial interest" in securities held by the organization;
(iii) the proprietary interest of a policy holder in a mutual insurance company, of a depositor in a mutual savings association, or a similar proprietary interest, is a "financial interest" in the organization only if the outcome of the proceeding could substantially affect the value of the interest;
(iv) ownership of government securities is a "financial interest" in the issuer only if the outcome of the proceeding could substantially affect the value of the securities.

(d) "proceeding" includes pretrial, trial, appellate review, or other stages of litigation.

D. Remittal of Disqualification

A judge disqualified by the terms of Canon 3C(1), except in the circumstances specifically set out in subsections (a) through (e), may, instead of withdrawing from the proceeding, disclose on the record the basis of his disqualification. If, based on such disclosure, the parties and lawyers, independently of the judge's participation, all agree

FOIA #57320 (URTS 16326) DocId: 7010318 Page 403

APPENDIX A—Continued

in writing that the judge's disqualification should be waived, the judge is no longer disqualified and may participate in the proceeding. The agreement, signed by all parties and lawyers, shall be incorporated in the record of the proceeding.

CANON 4

A JUDGE MAY ENGAGE IN ACTIVITIES TO IMPROVE THE LAW, THE LEGAL SYSTEM, AND THE ADMINISTRATION OF JUSTICE

A judge, subject to the proper performance of his judicial duties, may engage in the following quasi-judicial activities, if in doing so he does not cast doubt on his capacity to decide impartially any issue that may come before him:

A. He may speak, write, lecture, teach, and participate in other activities concerning the law, the legal system, and the administration of justice.

B. He may appear at a public hearing before an executive or legislative body or official on matters concerning the law, the legal system, and the administration of justice, and he may otherwise consult with an executive or legislative body or official, but only on matters concerning the administration of justice.

C. He may serve as a member, officer, or director of an organization or governmental agency devoted to the improvement of the law, the legal system, or the administration of justice. He may assist such an organization in raising funds and may participate in their management and investment, but should not personally participate in public fund-raising activities. He may make recommendations to public and private fund-granting agencies on projects and programs concerning the law, the legal system, and the administration of justice.

COMMENTARY

As a judicial officer and person specially learned in the law, a judge is in a unique position to contribute to the improvement of the law, the legal system, and the administration of justice, including revision of substantive and procedural law and improvement of criminal and juvenile justice. To the extent that his time permits, he is encouraged to do so, either independently or through a bar association, judicial conference, or other organization dedicated to the improvement of the law.

Extra-judicial activities are governed by Canon 5.

CANON 5

A JUDGE SHOULD REGULATE HIS EXTRA-JUDICIAL ACTIVITIES TO MINIMIZE THE RISK OF CONFLICT WITH HIS JUDICIAL DUTIES

A. Avocational Activities. A judge may write, lecture, teach, and speak on non-legal subjects, and engage in the arts, sports, and other social and recreational activities, if such avocational activities do not detract from the dignity of his office or interfere with the performance of his judicial duties.

COMMENTARY

Complete separation of a judge from extra-judicial activities is neither possible nor wise; he should not become isolated from the society in which he lives.

B. Civic and Charitable Activities. A judge may participate in civic and charitable activities that do not reflect adversely upon his impartiality or interfere with the performance of his judicial duties. A judge may serve as an officer, director, trustee, or non-legal advisor of an educational, religious, charitable, fraternal, or civic

APPENDIX A—Continued

organization not conducted for the economic or political advantage of its members, subject to the following limitations:

(1) A judge should not serve if it is likely that the organization will be engaged in proceedings that would ordinarily come before him or will be regularly engaged in adversary proceedings in any court.

COMMENTARY

The changing nature of some organizations and of their relationship to the law makes it necessary for a judge regularly to reexamine the activities of each organization with which he is affiliated to determine if it is proper for him to continue his relationship with it. For example, in many jurisdictions charitable hospitals are now more frequently in court than in the past. Similarly, the boards of some legal aid organizations now make policy decisions that may have political significance or imply commitment to causes that may come before the courts for adjudication.

(2) A judge should not solicit funds for any educational, religious, charitable, fraternal, or civic organization, or use or permit the use of the prestige of his office for that purpose, but he may be listed as an officer, director, or trustee of such an organization. He should not be a speaker or the guest of honor at an organization's fund-raising events, but he may attend such events.

(3) A judge should not give investment advice to such an organization, but he may serve on its board of directors or trustees even though it has the responsibility for approving investment decisions.

COMMENTARY

A judge's participation in an organization devoted to quasi-judicial activities is governed by Canon 4.

C. Financial Activities

(1) A judge should refrain from financial and business dealings that tend to reflect adversely on his impartiality, interfere with the proper performance of his judicial duties, exploit his judicial position, or involve him in frequent transactions with lawyers or persons likely to come before the court on which he serves.

(2) Subject to the requirements of subsection (1), a judge may hold and manage investments, including real estate, and engage in other remunerative activity, but should not serve as an officer, director, active partner, manager, advisor, or employee of any business other than a business wholly owned by members of the judge's family all of whom are related to the judge or his or her spouse within the third degree of relationship calculated according to the civil law system.

(3) A judge should manage his investments and other financial interests to minimize the number of cases in which he is disqualified. As soon as he can do so without serious financial detriment, he should divest himself of investments and other financial interests that might require frequent disqualification.

(4) Neither a judge nor a member of his family residing in his household should accept a gift, bequest, favor, or loan from anyone except as follows:

(a) a judge may accept a gift incident to a public testimonial to him; books supplied by publishers on a complimentary basis for official use; or an invitation to the judge and his spouse to attend a bar-related function or activity devoted to the improvement of the law, the legal system, or the administration of justice;

(b) a judge or a member of his family residing in his household may accept ordinary social hospitality; a gift, bequest, favor, or loan from a relative; a wedding or engagement gift; a loan from a lending institution in its regular course of business on the same terms generally available to persons who are not judges; or a scholarship or fellowship awarded on the same terms applied to other applicants;

APPENDIX A—Continued

(c) a judge or a member of his family residing in his household may accept any other gift, bequest, favor, or loan only if the donor is not a party or other person whose interests have come or are likely to come before him, and, if its value exceeds $100, the judge reports it in the same manner as he reports compensation in Canon 6C.

(5) For the purposes of this section "members of his family residing in his household" means any relative of a judge by blood or marriage, or a person treated by a judge as a member of his family, who resides in his household.

(6) A judge is not required by this Code to disclose his income, debts, or investments, except as provided in this Canon and Canons 3 and 6.

COMMENTARY

Canon 3 requires a judge to disqualify himself in any proceeding in which he has a financial interest, however small; Canon 5 requires a judge to refrain from engaging in business and from financial activities that might interfere with the impartial performance of his judicial duties; Canon 6 requires him to report all compensation he receives for activities outside his judicial office. A judge has the rights of an ordinary citizen, including the right to privacy of his financial affairs, except to the extent that limitations thereon are required to safeguard the proper performance of his duties. Owning and receiving income from investments do not as such affect the performance of a judge's duties.

(7) Information acquired by a judge in his judicial capacity should not be used or disclosed by him in financial dealings or for any other purpose not related to his judicial duties.

D. Fiduciary Activities. A judge should not serve as the executor, administrator, trustee, guardian, or other fiduciary, except for the estate, trust, or person of a member of his family, and then only if such service will not interfere with the proper performance of his judicial duties. "Member of his family" means any relative of a judge by blood, adoption, or marriage or any other person treated by a judge as a member of his family who resides, or has resided, in his household.

COMMENTARY

Mere residence in the household of a judge is insufficient for a person to be considered a member of the judge's family for purposes of this canon. The person must not only be treated by a judge as a member of his family but must have resided in the judge's household for a sufficient length of time and under such circumstances as to make it apparent that it was his principal place of abode.

As a family fiduciary a judge is subject to the following restrictions:

(1) He should not serve if it is likely that as a fiduciary he will be engaged in proceedings that would ordinarily come before him or if the estate, trust, or ward becomes involved in adversary proceedings in the court on which he serves or one under its appellate jurisdiction.

COMMENTARY

The Effective Date of Compliance provision of this Code qualifies this subsection with regard to a judge who is an executor, administrator, trustee, or other fiduciary at the time this Code becomes effective.

(2) While acting as a fiduciary a judge is subject to the same restrictions on financial activities that apply to him in his personal capacity.

COMMENTARY

A judge's obligation under this Canon and his obligation as a fiduciary may come into conflict. For example, a judge should resign as trustee if it would result in detriment to the trust to divest it of holdings whose retention would place the judge in violation of Canon 4D(3).

FOIA # 5772 (URTS 16326) DocId: 70105318 Page 404

APPENDIX A—Continued

E. Arbitration. A judge should not act as an arbitrator or mediator.

F. Practice of Law. A judge should not practice law.

G. Extra-Judicial Appointments. A judge should not accept appointment to a governmental committee, commission, or other position that is concerned with issues of fact or policy on matters other than the improvement of the law, the legal system, or the administration of justice, unless appointment of a judge is required by Act of Congress. A judge should not, in any event, accept such an appointment if his governmental duties would interfere with the performance of his judicial duties or tend to undermine the public confidence in the integrity, impartiality, or independence of the judiciary. A judge may represent his country, state, or locality on ceremonial occasions or in connection with historical, educational, and cultural activities.

COMMENTARY

Valuable services have been rendered in the past to the states and the nation by judges appointed by the executive to undertake important extra-judicial assignments. The appropriateness of conferring these assignments on judges must be reassessed, however, in light of the demands on judicial manpower created by today's crowded dockets and the need to protect the courts from involvement in extra-judicial matters that may prove to be controversial. Judges should not be expected or permitted to accept governmental appointments that could interfere with the effectiveness and independence of the judiciary.

The dangers attendant upon acceptance of extra-judicial governmental assignments are ordinarily less serious where the appointment of a judge is required by legislation. Such assignments ordinarily do not involve excessive commitments of time, and they typically do not pose a serious threat to the independence of the judiciary. Moreover, it is hardly the function of a Code of Judicial Conduct to compel judges to refuse, without careful regard to the circumstances, tasks Congress has seen fit to authorize as appropriate in the public interest. Accordingly, although legislatively prescribed extra-judicial assignments should be discouraged, where Congress requires the appointment of a judge to perform extra-judicial duties, the judge may accept the appointment provided that his services would not interfere with the performance of his judicial responsibilities or tend to undermine public confidence in the judiciary.

CANON 6

A JUDGE SHOULD REGULARLY FILE REPORTS OF COMPENSATION RECEIVED FOR QUASI-JUDICIAL AND EXTRA-JUDICIAL ACTIVITIES

A judge may receive compensation and reimbursement of expenses for the quasi-judicial and extra-judicial activities permitted by this Code, if the source of such payments does not give the appearance of influencing the judge in his judicial duties or otherwise give the appearance of impropriety, subject to the following restrictions:

A. Compensation. Compensation should not exceed a reasonable amount nor should it exceed what a person who is not a judge would receive for the same activity.

B. Expense Reimbursement. Expense reimbursement should be limited to the actual costs of travel, food, and lodging reasonably incurred by the judge and, where appropriate to the occasion, by his spouse. Any payment in excess of such an amount is compensation.

C. Public Reports. A judge should report the date, place, and nature of any activity for which he received compensation, and the name of the payor and the amount of compensation so received. Compensation or income of a spouse attributed to the judge by operation of a community property law is not extra-judicial compensation to the judge. His report should be made at least annually and should be filed as a public document in the office of the clerk of the court on which he serves or other office designated by rule of court.

APPENDIX A—Continued

CANON 7

A JUDGE SHOULD REFRAIN FROM POLITICAL ACTIVITY

A. Political Conduct in General

(1) A judge should not:

(a) act as a leader or hold any office in a political organization;

(b) make speeches for a political organization or candidate or publicly endorse a candidate for public office;

(c) solicit funds for or pay an assessment or make a contribution to a political organization or candidate, attend political gatherings, or purchase tickets for political party dinners, or other functions.

(2) A judge should resign his office when he becomes a candidate either in a primary or in a general election for any office.

(3) A judge should not engage in any other political activity; provided, however, this should not prevent a judge from engaging in the activities described in Canon 4.

APPENDIX B

RULES FOR PROCESSING COMPLAINTS OF JUDICIAL MISCONDUCT

JUDICIAL COUNCIL OF THE D.C. CIRCUIT

RULES FOR PROCESSING COMPLAINTS OF JUDICIAL MISCONDUCT

Preface. The following rules are adopted in conformity with and pursuant to the Judicial Councils Reform and Judicial Conduct and Disability Act of 1980, (P.L. 96-458, Oct. 15, 1980), 28 U.S.C. § 372(c).

Rule 1 Any person alleging that a circuit, district, or bankruptcy judge or a magistrate has engaged in conduct prejudicial to the effective and expeditious administration of the business of the courts, or alleging that such a judge or magistrate is unable to discharge all the duties of office by reason of a mental or physical disability, may file with the Clerk of the Court of Appeals of the Circuit a written complaint containing a brief statement of the facts constituting such conduct.

Rule 2 Upon receipt of a complaint filed under Rule 1, the Clerk shall promptly transmit such complaint to the Chief Judge of the Circuit, or, if the conduct complained of is that of the Chief Judge, to that circuit judge in regular active service next senior in date of commission (hereafter, for purposes of these rules, included in the term "Chief Judge"). The Clerk shall simultaneously transmit a copy of the complaint to the judge or magistrate whose conduct is the subject of the complaint.

FOIA # 57228 (URTS 16326) DocId: 7010521 Page 495

APPENDIX B—Continued

Rule 3 After expeditiously reviewing a complaint, the Chief Judge, by written order stating the reasons therefor, may:

(A) dismiss the complaint, upon finding it to be (i) not in conformity with Rule 1, (ii) directly related to the merits of a decision or procedural ruling, or (iii) frivolous, or

(B) conclude the proceeding upon determining that appropriate corrective action has been taken.

(C) Notice of the written order of the Chief Judge shall be transmitted to the complainant and to the judge or magistrate whose conduct is the subject of the complaint. The Chief Judge shall report to the Council on complaints dismissed or closed.

Rule 4 If the Chief Judge does not enter an order under Rule 3, such judge shall promptly—

(A) appoint a special committee composed of the Chief Judge and equal numbers of circuit and district judges of the Circuit to investigate the facts and allegations contained in the complaint;

(B) certify the complaint and any other documents pertaining thereto to each member of such committee; and

(C) provide written notice to the complainant and the judge or magistrate whose conduct is the subject of the complaint of the action taken under this rule.

Rule 5 (A) Each committee appointed under Rule 4 shall conduct an investigation as extensive as it considers necessary, and shall expeditiously file a comprehensive written report thereon with the Judicial Council of the Circuit. Such report shall present both the findings of the investigation and the committee's recommendations for necessary and appropriate action by the Judicial Council of the Circuit.

(B) The judge or magistrate whose conduct is the subject of the complaint shall be afforded an opportunity to appear (in person or by counsel) at proceedings conducted by the investigating panel, to present oral and documentary evidence, to compel the attendance of witnesses or the production of documents, to cross-examine witnesses, and to present argument orally or in writing.

(C) The judge or magistrate whose conduct is the subject of an investigation shall receive payment of attorney's fees in accordance with procedures established by the Director of the Administrative Office of the United States Courts.

(D) The complainant may be afforded an opportunity to appear at proceedings conducted by the investigating panel, if the panel concludes that the complainant could offer substantial information.

(E) A complainant appearing before an investigating panel may, at the discretion of the panel, be authorized to request payment of attorney's fees by the Director of the Administrative Office of the United States Courts.

Rule 6 Upon receipt of a report filed under Rule 5, the Judicial Council—

(A) may conduct any additional investigation which it considers to be necessary;

(B) shall take such action as is appropriate to assure the effective and expeditious administration of the business of the courts within the Circuit, including, but not limited to, any of the following actions:

(i) directing the chief judge of the district of the magistrate whose conduct is the subject of the complaint to take such action as the Judicial Council considers appropriate;

(ii) certifying disability of a judge appointed to hold office during good behavior whose conduct is the subject of the complaint, pursuant to the procedures and standards provided under 28 U.S.C. § 372(b);

(iii) requesting that any such judge appointed to hold office during good behavior voluntarily retire, with the provision that the length of service requirements under 28 U.S.C. § 371 shall not apply;

(iv) ordering that, on a temporary basis for a time certain, no further cases be assigned to any judge or magistrate whose conduct is the subject of a complaint;

(v) censuring or reprimanding such judge or magistrate by means of private communication;

(vi) censuring or reprimanding such judge or magistrate by means of public announcement;

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 406

APPENDIX B—Continued

(vii) ordering such other action as it considers appropriate under the circumstances, except that (I) in no circumstances may the Council order removal from office of any judge appointed to hold office during good behavior, and (II) any removal of a magistrate shall be in accordannce with 28 U.S.C. § 631, and any removal of a bankruptcy judge shall be in accordance with 28 U.S.C. § 153; and

(C) shall immediately provide written notice to the complainant and to such judge or magistrate of the action taken under this rule.

Rule 7 (A) In addition to the authority stated in Rule 6, the Judicial Council may, in its discretion, refer any complaint under these rules, together with the record of any associated proceedings and its recommendations for appropriate action, to the Judicial Conference of the United States.

(B) In any case in which the Judicial Council determines, on the basis of a complaint and an investigation under these rules, or on the basis of information otherwise available to the Council, that a judge appointed to hold office during good behavior has engaged in conduct—

(i) which might constitute one or more grounds for impeachment under article I of the Constitution; or

(ii) which, in the interests of justice, is not amenable to resolution by the Judicial Council, the Judicial Council shall promptly certify such determination, together with any complaint and a record of any associated proceedings, to the Judicial Conference of the United States.

(C) The Judicial Council acting under authority of this rule shall, unless contrary to the interests of justice, immediately submit written notice to the complainant and to the judge or magistrate whose conduct is the subject of the action taken under this rule.

Rule 8 In conducting any investigation under these rules, the Judicial Council, or a special investigating committee appointed under Rule 4, shall have full subpoena powers as provided in 28 U.S.C. § 332(d). Enforcement of such subpoenas shall be as provided in Rule 45(f), Federal Rules of Civil Procedure.

Rule 9 All papers, documents, and records of proceedings related to investigations conducted under these rules shall be confidential and shall not be disclosed by any person in any proceeding unless—

(A) the Judicial Council of the Circuit, the Judicial Conference of the United States, or the Senate or the House of Representatives by resolution, releases any such material which is believed necessary to an impeachment investigation or trial of a judge under article I of the Constitution; or

(B) release of such material in whole or in part is authorized in writing by the judge or magistrate who is the subject of the complaint and by the Chief Judge of the Circuit, the Chief Justice, or the chairman of the standing committee established under 28 U.S.C. § 331.

Rule 10 (A) A complainant, judge, or magistrate aggrieved by a final order of the Chief Judge under Rule 3 may petition the Council for review thereof. A complainant, judge, or magistrate aggrieved by an action of the Judicial Council under Rule 6 may petition the Judicial Conference of the United States for review thereof.

(B) No person shall be granted the right to intervene or to appear as amicus curiae in any proceeding before the Judicial Council under these rules.

Rule 11 Each written order to implement any action under Rule 6(B), which is issued by the Judicial Council, shall be made available to the public through the Clerk's Office of the Court of Appeals. Unless contrary to the interests of justice, each such order issued under this paragragh shall be accompanied by written reasons therefor.

Rule 12 These rules shall become effective October 1, 1981.

Sen. Res. 120

FOIA # 57720 (URTS 16326) DocId: 70105318 Page 407

Citation | Rank(R) | Database | Mode
141 Cong.Rec. S6823-01 | R 4 OF 58 | CR | Page
1995 WL 298415 (Cong.Rec.)
(Cite as: 141 Cong. Rec. S6823-01)
Congressional Record --- Senate
Proceedings and Debates of the 104th Congress, First Session
Wednesday, May 17, 1995

***S6823** SENATE RESOLUTION 120-ESTABLISHING A SPECIAL COMMITTEE ADMINISTERED BY THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Mr. D'AMATO (for himself and Mr. DOLE) submitted the following resolution; which was considered and agreed to:

S. RES. 120

Resolved,

SECTION 1. ESTABLISHMENT OF SPECIAL COMMITTEE.

(a) ESTABLISHMENT.-There is established a special committee administered by the Committee on Banking, Housing, and Urban Affairs to be known as the " Special Committee to Investigate Whitewater Development Corporation and Related Matters" (hereafter in this resolution referred to as the "special committee").

(b) PURPOSES.-The purposes of the special committee are-

(1) to conduct an investigation and public hearings into, and study of, whether improper conduct occurred regarding the way in which White House officials handled documents in the office of White House Deputy Counsel Vincent Foster following his death;

(2) to conduct an investigation and public hearings into, and study of, the following matters developed during, or arising out of, the investigation and public hearings concluded by the Committee on Banking, Housing, and Urban Affairs prior to the adoption of this resolution-

(A) whether any person has improperly handled confidential Resolution Trust Corporation (hereafter in this resolution referred to as the "RTC") information relating to **Madison Guaranty** Savings and Loan Association or Whitewater Development Corporation, including whether any person has improperly communicated such information to individuals referenced therein;

(B) whether the White House has engaged in improper contacts with any other agency or department in the Government with regard to confidential RTC information relating to **Madison Guaranty** Savings and Loan Association or Whitewater Development Corporation;

(C) whether the Department of Justice has improperly handled RTC criminal referrals relating to **Madison Guaranty** Savings and Loan Association or Whitewater Development Corporation;

(D) whether RTC employees have been improperly importuned, prevented, restrained, or deterred in conducting investigations or making enforcement recommendations relating to **Madison Guaranty** Savings and Loan Association or Whitewater Development Corporation; and

(E) whether the report issued by the Office of Government Ethics on July 31, 1994, or related transcripts of deposition testimony-

(i) were improperly released to White House officials or others prior to

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their testimony before the Committee on Banking, Housing, and Urban Affairs pursuant to Senate Resolution 229 (103d Congress); or

(ii) were used to communicate to White House officials or to others confidential RTC information relating to **Madison Guaranty** Savings and Loan Association or Whitewater Development Corporation;

(3) to conduct an investigation and public hearings into, and study of, all matters that have any tendency to reveal the full facts about-

(A) the operations, solvency, and regulation of **Madison Guaranty** Savings and Loan Association, and any subsidiary, affiliate, or other entity owned or controlled by **Madison Guaranty** Savings and Loan Association;

(B) the activities, investments, and tax liability of Whitewater Development Corporation and, as related to Whitewater Development Corporation, of its officers, directors, and shareholders;

(C) the policies and practices of the RTC and the Federal banking agencies (as that term is defined in section 3 of the Federal Deposit Insurance Act) regarding the legal representation of such agencies with respect to **Madison Guaranty** Savings and Loan Association;

***S6824** (D) the handling by the RTC, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the Federal Savings and Loan Insurance Corporation of civil or administrative actions against parties regarding **Madison Guaranty** Savings and Loan Association;

(E) the sources of funding and the lending practices of Capital Management Services, Inc., and its supervision and regulation by the Small Business Administration, including any alleged diversion of funds to Whitewater Development Corporation;

(F) the bond underwriting contracts between Arkansas Development Finance Authority and Lasater & Company; and

(G) the lending activities of Perry County Bank, Perryville, Arkansas, in connection with the 1990 Arkansas gubernatorial election;

(4) to make such findings of fact as are warranted and appropriate;

(5) to make such recommendations, including recommendations for legislative, administrative, or other actions, as the special committee may determine to be necessary or desirable; and

(6) to fulfill the constitutional oversight and informational functions of the Congress with respect to the matters described in this section.

SEC. 2. MEMBERSHIP AND ORGANIZATION OF THE SPECIAL COMMITTEE.

(a) MEMBERSHIP.-

(1) IN GENERAL.-The special committee shall consist of-

(A) the members of the Committee on Banking, Housing, and Urban Affairs; and

(B) the chairman and ranking member of the Committee on the Judiciary, or their designees from the Committee on the Judiciary.

(2) SENATE RULE XXV.-For the purpose of paragraph 4 of rule XXV of the Standing Rules of the Senate, service of a Senator as the chairman or other member of the special committee shall not be taken into account.

(b) ORGANIZATION OF SPECIAL COMMITTEE.-

(1) CHAIRMAN.-The chairman of the Committee on Banking, Housing, and Urban Affairs shall serve as the chairman of the special committee (hereafter in this resolution referred to as the "chairman").

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(2) RANKING MEMBER.-The ranking member of the Committee on Banking, Housing, and Urban Affairs shall serve as the ranking member of the special committee (hereafter in this resolution referred to as the "ranking member").

(3) QUORUM.-A majority of the members of the special committee shall constitute a quorum for the purpose of reporting a matter or recommendation to the Senate. A majority of the members of the special committee, or one-third of the members of the special committee if at least one member of the minority party is present, shall constitute a quorum for the conduct of other business. One member of the special committee shall constitute a quorum for the purpose of taking testimony.

(c) RULES AND PROCEDURES.-Except as otherwise specifically provided in this resolution, the special committee's investigation, study, and hearings shall be governed by the Standing Rules of the Senate and the Rules of Procedure of the Committee on Banking, Housing, and Urban Affairs. The special committee may adopt additional rules or procedures not inconsistent with this resolution or the Standing Rules of the Senate if the chairman and ranking member agree that such additional rules or procedures are necessary to enable the special committee to conduct the investigation, study, and hearings authorized by this resolution. Any such additional rules and procedures shall become effective upon publication in the Congressional Record.

SEC. 3. STAFF OF THE SPECIAL COMMITTEE.

(a) APPOINTMENTS.-To assist the special committee in the investigation, study, and hearings authorized by this resolution, the chairman and the ranking member each may appoint special committee staff, including consultants.

(b) ASSISTANCE FROM THE SENATE LEGAL COUNSEL.-To assist the special committee in the investigation, study, and hearings authorized by this resolution, the Senate Legal Counsel and the Deputy Senate Legal Counsel shall work with and under the jurisdiction and authority of the special committee.

(c) ASSISTANCE FROM THE COMPTRCLLER GENERAL.-The Comptroller General of the United States is requested to provide from the General Accounting Office whatever personnel or other appropriate assistance as may be required by the special committee, or by the chairman or the ranking member.

SEC. 4. PUBLIC ACTIVITIES OF THE SPECIAL COMMITTEE.

(a) IN GENERAL.-Consistent with the rights of persons subject to investigation and inquiry, the special committee shall make every effort to fulfill the right of the public and the Congress to know the essential facts and implications of the activities of officials of the United States Government and other persons and entities with respect to the matters under investigation and study, as described in section 1.

(b) DUTIES.-In furtherance of the right of the public and the Congress to know, the special committee-

(1) shall hold, as the chairman (in consultation with the ranking member) considers appropriate and in accordance with paragraph 5(b) of rule XXVI of the Standing Rules of the Senate, hearings on specific subjects, subject to consultation and coordination with the **independent counsel** appointed pursuant to chapter 40 of title 28, United States Code, in Division No. 94-1 (D.C. Cir.

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August 5, 1994) (hereafter in this resolution referred to as "the **independent counsel**");

(2) may make interim reports to the Senate as it considers appropriate; and

(3) shall make a final comprehensive public report to the Senate which contains-

(A) a description of all relevant factual determinations; and

(B) recommendations for legislation, if necessary.

SEC. 5. POWERS OF THE SPECIAL COMMITTEE.

(a) IN GENERAL.-The special committee shall do everything necessary and appropriate under the laws and the Constitution of the United States to conduct the investigation, study, and hearings authorized by section 1.

(b) EXERCISE OF AUTHORITY.-The special committee may exercise all of the powers and responsibilities of a committee under rule XXVI of the Standing Rules of the Senate and section 705 of the Ethics in Government Act of 1978, including the following:

(1) SUBPOENA POWERS.-To issue subpoenas or orders for the attendance of witnesses or for the production of documentary or physical evidence before the special committee. A subpoena or order may be authorized by the special committee or by the chairman with the agreement of the ranking member, and may be issued by the chairman or any other member of the special committee designated by the chairman, and may be served by any person designated by the chairman or the authorized member anywhere within or outside of the borders of the United States to the full extent permitted by law. The chairman, or any other member of the special committee, is authorized to administer oaths to any witnesses appearing before the special committee. If a return on a subpoena or order for the production of documentary or physical evidence is incomplete or accompanied by an objection, the chairman (in consultation with the ranking member) may convene a meeting or hearing to determine the adequacy of the return and to rule on the objection. At a meeting or hearing on such a return, one member of the special committee shall constitute a quorum. The special committee shall not initiate procedures leading to civil or criminal enforcement of a subpoena unless the person or entity to whom the subpoena is directed refuses to produce the required documentary or physical evidence after having been ordered and directed to do so.

(2) COMPENSATION AUTHORITY.-To employ and fix the compensation of such clerical, investigatory, legal, technical, and other assistants as the special committee, or the chairman or the ranking member, considers necessary or appropriate.

(3) MEETINGS.-To sit and act at any time or place during sessions, recesses, and adjournment periods of the Senate.

(4) HEARINGS.-To hold hearings, take testimony under oath, and receive documentary or physical evidence relating to the matters and questions it is authorized to investigate or study. Unless the chairman and the ranking member otherwise agree, the questioning of a witness or a panel of witnesses at a hearing shall be limited to one initial 30-minute turn each for the chairman and the ranking member, or their designees, including majority and minority staff, and thereafter to 10-minute turns by each member of the special committee if 5 or more members are present, and to 15-minute turns by each

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member of the special committee if fewer than 5 members are present. A member may be permitted further questions of the witness or panel of witnesses, either by using time that another member then present at the hearing has yielded for that purpose during the yielding member's turn, or by using time allotted after all members have been given an opportunity to question the witness or panel of witnesses. At all times, unless the chairman and the ranking member otherwise agree, the questioning shall alternate back and forth between members of the majority party and members of the minority party. In their discretion, the chairman and the ranking member, respectively, may designate majority or minority staff to question a witness or a panel of witnesses at a hearing during time yielded by a member of the chairman's or the ranking member's party then present at the hearing for his or her turn.

(5) TESTIMONY OF WITNESSES.-To require by subpoena or order the attendance, as a witness before the special committee or at a deposition, of any person who may have knowledge or information concerning any of the matters that the special committee is authorized to investigate and study.

(6) IMMUNITY.-To grant a witness immunity under sections 6002 and 6005 of title 18, United States Code, provided that the **independent counsel** has not informed the special committee in writing that immunizing the witness would interfere with the ability of the **independent counsel** successfully to prosecute criminal violations. Not later than 10 days before the special committee seeks a Federal court order for a grant of immunity by the special committee, the Senate Legal Counsel shall cause to be delivered to the **independent counsel** a written request asking the **independent counsel** promptly to inform the special committee in writing if, in the judgment of the **independent counsel,** the grant of immunity would interfere with the ability of the **independent counsel** successfully to prosecute criminal violations. The Senate Legal Counsel's written request of ***S6825** the **independent counsel** required by this paragraph shall be in addition to all notice requirements set forth in sections 6002 and 6005 of title 18, United States Code.

(7) DEPOSITIONS.-To take depositions and other testimony under oath anywhere within the United States, to issue orders that require witnesses to answer written interrogatories under oath, and to make application for the issuance of letters rogatory. All depositions shall be conducted jointly by majority and minority staff of the special committee. A witness at a deposition shall be examined upon oath administered by a member of the special committee or an individual authorized by local law to administer oaths, and a complete transcription or electronic recording of the deposition shall be made. Questions shall be propounded first by majority staff of the special committee and then by minority staff of the special committee. Any subsequent round of questioning shall proceed in the same order. Objections by the witness as to the form of questions shall be noted for the record. If a witness objects to a question and refuses to answer on the basis of relevance or privilege, the special committee staff may proceed with the deposition, or may, at that time or at a subsequent time, seek a ruling on the objection from the chairman. If the chairman overrules the objection, the chairman may order and direct the witness to answer the question, but the special committee shall not initiate procedures leading to civil or criminal enforcement unless the witness refuses to answer after having been ordered and directed to answer.

(8) DELEGATIONS TO STAFF.-To issue commissions and to notice depositions for

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staff members to examine witnesses and to receive evidence under oath administered by an individual authorized by local law to administer oaths. The special committee, or the chairman with the concurrence of the ranking member, may delegate to designated staff members of the special committee the power to issue deposition notices authorized pursuant to this paragraph.

(9) INFORMATION FROM OTHER SOURCES.-To require by subpoena or order-

(A) any department, agency, entity, officer, or employee of the United States Government;

(B) any person or entity purporting to act under color or authority of State or local law; or

(C) any private person, firm, corporation, partnership, or other organization;

to produce for consideration by the special committee or for use as evidence in the investigation, study, or hearings of the special committee, any book, check, canceled check, correspondence, communication, document, financial record, paper, physical evidence, photograph, record, recording, tape, or any other material relating to any of the matters or questions that the special committee is authorized to investigate and study which any such person or entity may possess or control.

(10) RECOMMENDATIONS TO THE SENATE.-To make to the Senate any recommendations, by report or resolution, including recommendations for criminal or civil enforcement, which the special committee may consider appropriate with respect to-

(A) the willful failure or refusal of any person to appear before it, or at a deposition, or to answer interrogatories, in compliance with a subpoena or order;

(B) the willful failure or refusal of any person to answer questions or give testimony during the appearance of that person as a witness before the special committee, or at a deposition, or in response to interrogatories; or

(C) the willful failure or refusal of-

(i) any officer or employee of the United States Government;

(ii) any person or entity purporting to act under color or authority of State or local law; or

(iii) any private person, partnership, firm, corporation, or organization;

to produce before the special committee, or at a deposition, or at any time or place designated by the committee, any book, check, canceled check, correspondence, communication, document, financial record, paper, physical evidence, photograph, record, recording, tape, or any other material in compliance with any subpoena or order.

(11) CONSULTANTS.-To procure the temporary or intermittent services of individual consultants, or organizations thereof.

(12) OTHER GOVERNMENT PERSONNEL.-To use, on a reimbursable basis and with the prior consent of the Government department or agency concerned, the services of the personnel of such department or agency.

(13) OTHER CONGRESSIONAL STAFF.-To use, with the prior consent of any member of the Senate or the chairman or the ranking member of any other Senate committee or the chairman or ranking member of any subcommittee of any committee of the Senate, the facilities or services of the appropriate members of the staff of such member of the Senate or other Senate committee or subcommittee, whenever the special committee or the chairman or the ranking

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member considers that such action is necessary or appropriate to enable the special committee to conduct the investigation, study, and hearings authorized by this resolution.

(14) ACCESS TO INFORMATION AND EVIDENCE.-To permit any members of the special committee, staff director, counsel, or other staff members or consultants designated by the chairman or the ranking member, access to any data, evidence, information, report, analysis, document, or paper-

(A) that relates to any of the matters or questions that the special committee is authorized to investigate or study under this resolution;

(B) that is in the custody or under the control of any department, agency, entity, officer, or employee of the United States Government, including those which have the power under the laws of the United States to investigate any alleged criminal activities or to prosecute persons charged with crimes against the United States without regard to the jurisdiction or authority of any other Senate committee or subcommittee; and

(C) that will assist the special committee to prepare for or conduct the investigation, study, and hearings authorized by this resolution.

(15) REPORTS OF VIOLATIONS OF LAW.-To report possible violations of any law to appropriate Federal, State, or local authorities.

(16) EXPENDITURES.-To expend, to the extent that the special committee determines necessary and appropriate, any money made available to the special committee by the Senate to carry out this resolution.

(17) TAX RETURN INFORMATION.-To inspect and receive, in accordance with the procedures set forth in sections 6103(f)(3) and 6104(a)(2) of the Internal Revenue Code of 1986, any tax return or tax return information, held by the Secretary of the Treasury, if access to the particular tax-related information sought is necessary to the ability of the special committee to carry out section 1(b)(3)(B).

SEC. 6. PROTECTION OF CONFIDENTIAL INFORMATION.

(a) NONDISCLOSURE.-No member of the special committee or the staff of the special committee shall disclose, in whole or in part or by way of summary, to any person other than another member of the special committee or other staff of the special committee, for any purpose or in connection with any proceeding, judicial or otherwise, any testimony taken, including the names of witnesses testifying, or material presented, in depositions or at closed hearings, or any confidential materials or information, unless authorized by the special committee or the chairman in concurrence with the ranking member.

(b) STAFF NONDISCLOSURE AGREEMENT.-All members of the staff of the special committee with access to confidential information within the control of the special committee shall, as a condition of employment, agree in writing to abide by the conditions of this section and any nondisclosure agreement promulgated by the special committee that is consistent with this section.

(c) SANCTIONS.-

(1) MEMBER SANCTIONS.-The case of any Senator who violates the security procedures of the special committee may be referred to the Select Committee on Ethics of the Senate for investigation and the imposition of sanctions in accordance with the rules of the Senate.

(2) STAFF SANCTIONS.-Any member of the staff of the special committee

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who violates the security procedures of the special committee shall immediately be subject to removal from office or employment with the special committee or such other sanction as may be provided in any rule issued by the special committee consistent with section 2(c).

(d) STAFF DEFINED.-For purposes of this section, the term "staff of the special committee" includes-

(1) all employees of the special committee;

(2) all staff designated by the members of the special committee to work on special committee business;

(3) all Senate staff assigned to special committee business pursuant to section 5(b)(13);

(4) all officers and employees of the Office of Senate Legal Counsel who are requested to work on special committee business; and

(5) all detailees and consultants to the special committee.

SEC. 7. RELATION TO OTHER INVESTIGATIONS.

(a) PURPOSES.-The purposes of this section are-

(1) to expedite the thorough conduct of the investigation, study, and hearings authorized by this resolution;

(2) to promote efficiency among all the various investigations underway in all branches of the United States Government; and

(3) to engender a high degree of confidence on the part of the public regarding the conduct of such investigation, study, and hearings.

(b) SPECIAL COMMITTEE ACTIONS.-To carry out the purposes stated in subsection (a), the special committee is encouraged-

(1) to obtain relevant information concerning the status of the investigation of the **independent counsel,** to assist in establishing a hearing schedule for the special committee; and

(2) to coordinate, to the extent practicable, the activities of the special committee with the investigation of the **independent counsel.**

SEC. 8. SALARIES AND EXPENSES.

A sum equal to not more than $950,000 for the period beginning on the date of adoption of this resolution and ending on February 29, 1996, shall be made available from the contingent fund of the Senate out of the Account for Expenses for Inquiries and Investigations for payment of salaries and other expenses of the special committee under this resolution, which shall include not more ***S6826** than $750,000 for the procurement of the services of individual consultants or organizations thereof, in accordance with section 5(b)(11). Payment of expenses shall be disbursed upon vouchers approved by the chairman, except that vouchers shall not be required for the disbursement of salaries paid at an annual rate.

SEC. 9. REPORTS; TERMINATION.

(a) COMPLETION OF DUTIES.-

(1) IN GENERAL.-The special committee shall make every reasonable effort to complete, not later than February 1, 1996, the investigation, study, and

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hearings authorized by section 1.

(2) EVALUATION OF PROGRESS.-The special committee shall evaluate the progress and status of the investigation, study, and hearings authorized by section 1 and, not later than January 15, 1996, make recommendations with respect to the authorization of additional funds for a period following February 29, 1996. If the special committee requests the authorization of additional funds for a period following February 29, 1996, the Majority Leader and the Democratic Leader shall meet and determine the appropriate timetable and procedures for the Senate to vote on any such request.

(b) FINAL REPORT.-

(1) SUBMISSION.-The special committee shall promptly submit a final public report to the Senate of the results of the investigation, study, and hearings conducted by the special committee pursuant to this resolution, together with its findings and any recommendations.

(2) CONFIDENTIAL INFORMATION.-The final report of the special committee may be accompanied by such confidential annexes as are necessary to protect confidential information.

(3) CONCLUSION OF BUSINESS.-After submission of its final report, the special committee shall promptly conclude its business and close out its affairs.

(c) RECORDS.-Upon the conclusion of the special committee's business and the closing out of its affairs, all records, files, documents, and other materials in the possession, custody, or control of the special committee shall remain under the control of the Committee on Banking, Housing, and Urban Affairs.

SEC. 10. COMMITTEE JURISDICTION AND RULE XXV.

The jurisdiction of the special committee is granted pursuant to this resolution, notwithstanding the provisions of paragraph 1 of rule XXV of the Standing Rules of the Senate relating to the jurisdiction of the standing committees of the Senate.

141 Cong. Rec. S6823-01, 1995 WL 298415 (Cong.Rec.)

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1995 WL 455181 (F.D.C.H.) | R 6 OF 18 | USTESTIMONY | Page

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Verbatim Transcript
August 01, 1995

Senate
Special Senate Whitewater Committee
Hearing

Day Seven of the Special Hearings Into Investments Made by President and Mrs. Clinton and Articles Allegedly Removed from the Office of Vince Foster.

WHITEWATER SPECIAL COMMITTEE

AUGUST 1, 1995

SPEAKERS LIST: SENATOR ALFONSE D'AMATO, R-NY
SENATOR PAUL SARBANES, D-MD
ROBERT LANGSTON, U.S. PARK POLICE CHIEF
DEBORAH GORHAM, EXECUTIVE ASSISTANT TO VINCE FOSTER

[*]
D'AMATO: ...statement that he wants to make. Senator Sarbanes.

SARBANES: Mr. Chairman, first of all, happy birthday.

D'AMATO: Thank you.
SARBANES: Secondly, and more ... I'm very much concerned about this leak problem. I've raised this before, but now we've had a situation in which apparently actual deposition transcripts were given to the press. These are the, as I understand it, the actual documents or copies of the documents, and it directly contravenes every procedure of the Committee, which were worked out very carefully and for very good reason.

Now, section six of the resolution provides for the protection of confidential information and states non-disclosure, and no member of the Special Committee or the staff shall disclose in whole or in part to any person other than other staff or other members various material. Then there's a non-disclosure agreement which members of the staff sign. Now this isn't the...we've had previous problems here that I've raised where people have disclosed information, often erroneous information. So you've had articles then written that completely misstate the situation. Witnesses suffer as a consequence of that.

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That was drawn out in the course of previous testimony here. Ms. Mathews, for instance, was written up as having said certain things which she didn't say and which became very clear in her testimony. And now we have a situation in which apparently the actual transcript of the deposition itself is being given out.

This is rather important, and it's kind of interesting, because I was reading, you know, these become available to the members the night before under our procedures. So I was reading through one of the depositions of one of the witnesses here this morning, and just to underscore why it's important for the witnesses, let me just read from that transcript very quickly. One of the deponents, one of the witnesses on our first panel, they asked about the release of the transcripts, and were told by Mr. Jiuffra, who was doing the questioning at that point for the **Committee,** "Know the **depositions** will be treated as **Committee-confidential** until that time," meaning the time of the testimony here, meaning only a limited number of people can see the deposition, that people have signed confidentiality agreements. And then later the witness herself said, was asked whether they understood what had just been said about the procedures, and said I do.

There are, however, leaks obviously because we continue to read about them in the paper, the people that you've deposed to dates. So where is the confidentiality being violated? And Mr. Jiuffra said, "do you want to go off the record for a second?" And then they went off the record, a discussion ensued, and then Mr. Jiuffra, when they came back on the record, just to briefly summarize, we discussed some of the procedures that the Committee has in place to protect the confidentiality of deposition transcripts. That's what the depondent was told. And, of course, the Committee did put those procedures in place last summer.

Now, if the procedures, they're obviously not being adhered to and I must say, Mr. Chairman, I think there's a problem which requires looking, very intense looking into on the part of the Committee, because obviously someone is breaking all of our, breaking all of our procedures here. We had the...

D'AMATO: Well, I wish that all of our members were here to hear the concern that you have very aptly and correctly raised. I believe that this is a betrayal of the work of our counsels and their staff and indeed of the Committee and its members.

(SPEAKER CORRECTION)

D'AMATO: Senators, from both sides, were endeavoring to get the facts, and to do it in a way that is not prejudicial. I can only say that I will work with you, and ask our two counsels to do anything and everything they can necessary, to find a manner in which to secure

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whatever of the depositions and testimony has been given. It is difficult, if not impossible, without the good faith of those people, not only on the committee but the staffers. I do not believe that any senator, on either side, has violated the sacred trust.

I do believe that there is a staffer or staffers who for their own reason, whether it is to aggrandize themselves with the media, get their little oar in the water, show what kind of pull or knowledge they have, has undertaken this. It undermines the credibility of all of the work that we undertake when they engage in this kind of activity.

I think we can continue to lament about it, but I'd like to suggest that we see if we can't--I don't know what else we can do--except keep everything under lock and key to the point that they can't even remove any documents, not even to work. I know there have been certain procedures. And I just spell out to the lame brain who has undertaken this kind of thing, that they do terrible damage to the entire process and to the people who come and who do testify.

And again, to this committee and to every member of the committee they undermine. I don't know what to say. I've spoken. I've sought out individuals. I've spoken to staffs. Maybe we'll have to get them together again. Maybe we'll have to --What do they do when they have a criminal trial? They put all the people, keep them incommunicado from getting certain information. Maybe we'll have to get the staffs in the senate to. What do we call that? Maybe we'll have to sequester. And the staff now, I mean this really is incredible. I don't think we should. It is important. I share your concern. And if Mr. Ben-Veniste and Mr. Chertoff and yourself or I can attempt to impose better security, why I would look for anything I can in that nature within reason to insure that.

SARBANES: Well, Mr. Chairman, I think we can focus this in much more finally. As I understand our procedures, which I assume have been followed, an agreement was worked out whereby the deposition transcripts would not be given to the members of the committee or their staff until the evening before the witnesses appearance in front of the committee.

In other words, last night we, the members, received the transcripts for the witnesses who are coming in today. Now the transcripts that were leaked were for witnesses who weren't even coming this week. They're coming next week. So presumably, if the procedures were followed, and I have no reason to think they weren't, members and member's staffs do not have access to those transcripts.

SARBANES: The only people having access to those transcripts would be staff of the committee. so it seems to me that we can, we

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can focus in very directly there. And I think that your suggestion to Mr. Chertoff and Mr. Ben-Veniste undertake to do that, in consultation with us is, is a very good suggestion. Particularly, when as I just quoted you had one deponent who asked about this very issue and was given assurances by Mr. Jiuffra with respect to it.

D'AMATO: Well, I'm -- again I renew the, the agreement that we undertake this together. Have our counsels pursue this matter and see if we can't narrow and maybe even get a better idea as to who exactly was responsible for this. We're just working too hard and doing too much good work to have this jeopardized in this kind of manner. Yes, Senator.

(UNKNOWN): Mr. Chairman, I think it is even a little more complicated than Senator Sarbanes suggests because here. You have Mr. Margolis, who is clearly one of the key players in all this. I ask my staff some time ago if we had a deposition, they said no, I think he had a triple bypass. We did not have a deposition.

But this is not the leak from a deposition. It's from E-Mail, which I don't think my staff doesn't seem to have. I don't think other staffs have, and it is the selective and distorted leaking that I think does concern us. And I appreciate your attitude and I know it is difficult in this body to prevent leaking. But I think we should try to, so that we get balance out there and not a distorted picture of what's taking place.

D'AMATO: I share the Senators concern and I'm going to ask that again that our counsels see -- we're going to have a vote at 10 o'clock. My initial intent was to see if we could not get the witnesses up, swear them in, maybe we'll take their testimony and adjourn for that, that vote.

But I'm going to ask counsels to pursue the matter, see what we can do. And, and accept again, to the staffers, staffers are doing this. You're not doing anything but really jeopardizing these hearings. And I have to tell you what we will do in the future, will be to be even more restrictive, as it relates to the, the depositions. And the availability of the deposition, because it's become obvious to this Senator, that they will not be able to be made available at the staffers. And that only Senators at certain times, if we have to keep it to that, to that manner of modality, we'll have the ability to see them until the night before.
Now, that will necessarily make it more difficult for the participation of the full committee. But I see no other recourse, certainly at this particular time. There's little that we can do, as it relates to those depositions that have already been taken. And the access that has been afforded at this point.

But I'm going to ask that our counsels review the matter and give

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us some recommendations. Then we'll confer with all of the members of the committee, as it relates to the manners in which we will proceed to, to provide as much in the way of, of secrecy, so to speak or guarding the contents of these documents, so that they are not selectively released.

D'AMATO: I have not read any of these depositions, because I didn't want to be in the position of inadvertently responding to a question, recall something that I may have read that would not be appropriate, and put that in a response. So I have deliberately refrained from that. I don't think it comes from any of the members, but I do think there is at least a staffer who thinks he's playing some wonderful public service. And he or she is not doing that.

Why don't we get our witnesses up -- the first panel, and we'll get any statement they want to make, we'll swear them in, and I don't think it's worthwhile starting, because we will have a vote at 10:00, but immediately after that vote, we'll come back and resume.

I think we have Deborah Gorham and Linda Tripp. Please remain standing. Raise your right hand. Do you swear and affirm that the testimony that you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

GORHAM/TRIPP: I do.

D'AMATO: Deborah Gorham, you are an assistant to the associate counsel to the President, a former assistant to the deputy counsel to the President, Vincent Foster. Is that correct?

GORHAM: I'm sorry, Chairman D'Amato.

D'AMATO: You were formerly the executive assistant to the deputy counsel to the President, Vincent Foster?

GORHAM: I was.

D'AMATO: Do you have a statement you'd like to give, Ms. Gorham?

GORHAM: Yes, sir, I do. My name is Deborah Gorham. I now work at a private law firm in Washington, DC. I worked for Vincent Foster as an executive assistant for a very brief period of time -- from March 8, 1993 until July 20, 1993.

During that time, we had a very professional working relationship. I had great respect for Vincent Foster, and his death was a tragic loss. It affected me deeply, and I feel great sympathy for the Foster family and hope that this matter will soon be put to rest. I am here to cooperate fully to the best I can. Thank you.

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D'AMATO: Thank you very much, Ms. Gorham. Linda Tripp.
TRIPP: Yes, Chairman.

D'AMATO: Do you have a statement, Linda?

TRIPP: I do, briefly.

D'AMATO: We'll be happy to receive it.

TRIPP: My name is Linda Tripp. From April 93 through April 94, I served as executive assistant to the counsel to the President, Bernie Nussbaum. I worked in the same suite of offices as Vince Foster at the time he died. I am prepared at this time to answer any questions you have regarding the handling of documents following the death of Mr. Foster. Thank you.

D'AMATO: May I ask you, do you still work at the White House?

TRIPP: I work for the Department of Defense at the Pentagon.

D'AMATO: First of all, let me say that we very much appreciate your cooperation, and if you have been placed in any inconvenience as a result of anybody putting out, I don't believe to date there's been any leaking of your depositions, we certainly are concerned about that.

D'AMATO: We certainly are concerned about that. I have been informed by staff that you have been most cooperative, both of you. And we deeply appreciate your cooperation and understand the sensitivity of this matter. Now, I'm going to ask the ranking member if he thinks we should begin or should we take a break now, given that the vote is supposedly going to start in five minutes. OK, we're going to take a break. We'll probably be back at about quarter after ten to resume. Mr. Chertoff will then put some questions to you. No trick questions, OK?

We stand in recess until the conclusion of the vote that's about to start.

GORHAM: It's simply based on recollections in, over the last two years.

CHAFFE: Putting aside the particular day, and I should tell you we have some independent evidence that the two of them were actually in the office on the 22nd, which would be the week of Mr. Foster's death, would you tell us what you recall of the occasion on which Mr. Nussbaum and Ms. Williams were in Mr. Foster's office?

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GORHAM: Mr. Nussbaum had called me into Mr. Foster's office and asked me to state to him what was in, what were the file drawers, what were the file folders in the file drawer that contained the President's and First Lady's personal and financial documents.

CHAFFE: Was Mr. Nussbaum alone at that point?

GORHAM: He was not.

CHAFFE: Was Mr. Nussbaum alone at the point?

GORHAM: He was not.

CHAFFE: Who was with him?

GORHAM: Miss Maggie Williams.

CHAFFE: Where were they in the office when you were called in?

GORHAM: Mr. Nussbaum was seated at a club chair in front of Mr., in the front of Mr. Foster's desk. Miss Williams was standing on the other side of the table of the club chair in front of Mr. Foster's sofa.

CHAFFE: And would you tell us what you said to Mr. Nussbaum, and what happened?

GORHAM: I stated if I would, and walked around Mr. Foster's desk, and pulled open the drawer that contained the President's and First Lady's personal and financial documents.

CHAFFE: Where was that drawer?

GORHAM: If you were seated at Mr. Foster's desk, it was to the left, and there were four drawers and a cabinet and it was the farthest left at the top.
CHAFFE: When you pulled open the drawer, what did you see?

GORHAM: I saw Pendaflex folders and file folders. And I did not see a index that normally would have been there, listing the names of the files.

CHAFFE: What index are you referring to?

GORHAM: I maintained indexes for all file drawers that I recall. And listed the contents of the names of each of the folders in each drawer.

CHAFFE: And you say when you opened the drawer on that day, in

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the presence of Mr. Nussbaum and Miss Williams that index was not where you normally kept it?

GORHAM: No, sir, it was not in that drawer.

CHAFFE: Did you see that index anywhere else that day?

GORHAM: No, sir.

CHAFFE: Now, after you had opened the drawer, what did you do?

GORHAM: I started to tell Mr. Nussbaum, read him the name of those file folders, at which time after the first few names to ask me to stop and stated to me that he would take care of that himself.

CHAFFE: And then what did you do?

GORHAM: I left the office of Mr. Foster's.

CHAFFE: Now, do you remember how long Mr. Nussbaum and Miss Williams remained in the office after you left?

GORHAM: I do not recall exactly how long it was?

CHAFFE: Was there a point that you were called back in by Mr. Nussbaum?

GORHAM: I don't believe so. That he would called me back in.

CHAFFE: And tell us what happened there?

GORHAM: I sat down at Mr. Foster's desk. And I opened his metal desk drawer and in there I found personal items such as checks that were written to Mr. Foster, and his life insurance policy.

CHAFFE: And, why did you do that?

GORHAM: I do not recall if, why I sat down at his desk an did that.

CHAFFE: At the point that you went back in to open up the middle desk drawer, was Ms. Williams still there with Mr. Nussbaum?

GORHAM: She was.

CHAFFE: What did you do after you opened the door?

GORHAM: I looked in, and then I closed it, and then left the office.

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CHAFFE: Do you remember seeing during this period of time, either the first or second time you went into the office, a box or boxes in the offices?

GORHAM: I'm sorry, would you repeat the question?

CHAFFE: During either the first time you went in, or the second time you went in on this occasion, with Mr. Nussbaum and Ms. Williams, did you see a box, or boxes in the office?

GORHAM: Yes, sir, I did.

CHAFFE: And, did there come a point later that something happened with those boxes?

GORHAM: Yes, sir.

CHAFFE: Tell us about that.

GORHAM: Mr. Nussbaum asked me to have the boxes moved out of Mr. Foster's office, and I asked Mr. Tom Castleton if he would carry them.

CHAFFE: And who was Tom Castleton?

GORHAM: Mr. Castleton was a staff assistant in our office.

CHAFFE: Can you tell us what happened?

GORHAM: Mr. Castleton picked them and carried them out behind Miss Williams. And the last the that I saw of them, noticed them was in the door just outside of our suite.

CHAFFE: Did you know where the boxes were the boxes were going?

GORHAM: No, sir.

CHAFEE: At any point on that day, getting your attention back to this index you've described, did you access your computer and revise that index on that day?

TRIPP: I don't recall if I accessed my computer in any way. I do not recall, I do not recall looking at that index on the hard drive.

CHAFEE: Now, let me turn to you, Miss Tripp, for a moment. Were you around on the day that Maggie Williams, the chief of staff for the First Lady and Mr. Castleton took a box or boxes out of Mr. Foster's office?

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TRIPP: I recall Tom Castleton removing a box.

CHAFEE: And, what do you recall about the circumstances of that?

TRIPP: My recollection is that the box or boxes were placed in front of Deb Gorham's desk. My next recollection is that Tom Castleton is physically carrying a box out of the safe.

CHAFEE: What was your understanding at that time of where the box or boxes were going?

TRIPP: Until I asked, I had no idea where they were going.

CHAFEE: Who did you ask?

TRIPP: I asked Deb Gorham and later Tom Castleton when he returned.

CHAFEE: And what did you learn?

TRIPP: That the boxes were going and had been delivered to the residence.

CHAFEE: That's the White House resident?

TRIPP: Yes, sir.

CHAFEE: I also, Miss Tripp, just to turn from you for a moment, and focusing your attention on . . .

(UNKNOWN): Mr. Chairman, can we ask how big a box are we talking about, bigger than a bread box, or a file cabinet? How many files are we talking about?

TRIPP: A box. I can't define the size of the box. It wasn't a two-man box. One person could easily carry the box.

CHAFEE: Were these files standing vertically? Were they lying down? Was the box 10 inches tall so that the files could be vertically, or was it three inches tall? How many documents, is what I'm after. I really don't care about the size of the box.

TRIPP: I don't know.

CHAFEE: Ms. Gorham, maybe you, do you remember how big the box was and what it was like?

GORHAM: To the best that I could recall the size of the boxes were the size of a small box that would hold approximately four or five reams of photocopy paper.

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D'AMATO: OK, that's helpful. Thank you, I'm sorry to interrupt.

CHAFEE: Let me keep your attention focused on this same time period, Ms. Tripp, this two-day period between Mr. Foster's death and funeral. Do you remember Susan Thomases making calls to Bernard Nussbaum during that period of time?

TRIPP: I have a recollection of speaking with Susan Thomases during that time.

CHAFEE: What about the First Lady? Do you have a recollection of her having a telephone conversation with Mr. Nussbaum?

TRIPP: I don't have a clear recollection of the First Lady speaking to him during that timeframe.

CHAFEE: Do you have some kind of a recollection of it?

TRIPP: I know at one point, there was a telephone conversation between Mr. Nussbaum and Mrs. Clinton. I don't recall when that was.

CHAFEE: Do you recall that it occurred during this period of time in a day or two after Mr. Foster's death?

TRIPP: I thought so, yes.

CHAFEE: Do you remember what the subject of that conversation was, or did you ever learn the subject of that conversation between the First Lady and Mr. Nussbaum in the day or two after Mr. Foster's death?

TRIPP: No, sir, I would have had no reason to know that.

CHAFEE: Do you remember how long the conversation was?

TRIPP: No, sir, I don't.

CHAFEE: Now, Ms. Tripp, I also want to ask you in this period of time, do you recall an occasion you had a conversation with Ms. Gorham concerning something that was seen in the bottom of Mr. Foster's briefcase?

TRIPP: Yes, sir.

CHAFEE: Would you tell us what you recall about the circumstances of that conversation?

TRIPP: I am uncertain as to what day and what time this

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conversation took place.

CHAFEE: When you say what day, you mean it could have either been the Wednesday or the Thursday following Mr. Foster's death?

TRIPP: To the best of my recollection, it was one of those two days, yes, sir.

CHAFEE: Tell us about the circumstances.

TRIPP: The conversation followed Deborah's return to the reception area suite after having been called into one of the two principal's offices, either...

CHAFEE: You said...I'm sorry, go ahead.

TRIPP: Either Mr. Nussbaum's or Mr. Foster's, I'm unclear as to it. When she returned, I asked her, had there been anything found, was there any indication as to why, a note anything. And she said, no. And I pursued it, and said did you look everywhere? Did you look in the briefcase? And she said, the briefcase was empty. There was nothing in there but a bunch of little yellow sticky notes.

CHAFEE: Now, you say this conversation occurred after Ms. Gorham came out of a meeting with, that either took place inside Mr. Nussbaum's office or inside Mr. Foster's office.

TRIPP: Yes, sir.

CHAFEE: Does the fact that the conversation you had with her had to do with searching for any note or searching for an indication of motivation help you to remember that it's likely this meeting occurred in Mr. Foster's office?

TRIPP: I just don't know, sir.

CHAFEE: You'd agree with me, at least, that there was no reason to search in Mr. Nussbaum's office for evidence of a note or anything of that sort. Correct?

TRIPP: Again, I don't know. I don't know what had transpired prior to that, whether something had perhaps been moved to Mr. Nussbaum's office. I had clearly no idea.

CHAFEE: But your recollection is in any event that after Ms. Gorham came out of this meeting, you initiated the questions about whether there had been a search for a note or some other kind of indication of why Mr. Foster killed himself?

TRIPP: Absolutely.

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CHAFEE: And it was in connection with that that Ms. Gorham said to you, again, as precisely as you can recall, what about the briefcase?

TRIPP: I don't recall Deborah saying she looked in the briefcase. I recall her saying either it was empty or there is nothing in there, followed by, except for a bunch of little yellow sticky notes, she may have said, at the bottom. My understanding was there was nothing else but scattered little yellow sticky notes.

CHAFEE: Ms. Gorham, do you recall this conversation with Ms. Tripp?

GORHAM: No, I'm sorry, I do not.

CHAFEE: So, you can't, you can't help us anymore with this conversation?

GORHAM: No, I just don't recall the conversation.

CHAFEE: Let me now take you forward to Monday, which was Monday the 26th of July, which is the Monday of the following week. Ms. Gorham, do you remember in the afternoon on that day Mr. Neuwirth, who is one of the associate counsels to Mr. Nussbaum, coming out of Mr. Foster's office with a briefcase?

GORHAM: I recall Mr. Neuwirth coming out of Mr. Foster's office with a briefcase. I don't recall if it was in the afternoon or the morning.

CHAFEE: And where did he go with the briefcase?

GORHAM: He went into Mr. Nussbaum's office and slammed the door.

CHAFEE: And then tell us what you saw of the comings and goings thereafter.

GORHAM: To the best of my memory, Mr. Neuwirth came out and asked one of the assistants to find Mr. Nussbaum. Later, Mr. Nussbaum returned to the office, went into his office, slammed the door. A few minutes later, Mr. Nussbaum opened the door, exited, slammed the door, and walked down the hallway.

CHAFEE: And then what else happened?

GORHAM: And then, I believe Mr. Burton, Bill Burton, might have appeared next, going into Mr. Nussbaum's office. And then other people, I think, came in, straggling, but I don't recall who they

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were.

CHAFEE: And was the office closed? Was the door to Mr. Nussbaum's office closed except when people were coming and going?

GORHAM: Yes, sir.

CHAFEE: Ms. Tripp, do you remember this occurrence on Monday?

TRIPP: I remember Steve Neuwirth opening the door, yes.

CHAFEE: And asking for somebody?

TRIPP: Yes, sir.

CHAFEE: And you remember Mr. Burton coming in?

TRIPP: I didn't have an independent recollection Mr. Burton coming back to our suite until I went over the E-mail traffic.

CHAFEE: And that refreshed your memory?

TRIPP: It did.

CHAFEE: Do you remember the First Lady coming into that, into Mr. Nussbaum's office during that same period?

TRIPP: Again, I did not have an independent recollection until I read the E-mail traffic.

CHAFEE: But now you do remember that?

TRIPP: Yes, sir.

CHAFEE: During that same period of coming and going, did you have a discussion with Mr. Clifford Sloan about something?

TRIPP: Actually, are you referring to that particular time period?

CHAFEE: Yes.

TRIPP: No, sir.

CHAFEE: How about later that day?

TRIPP: Later that evening I did.

CHAFEE: Tell us about that.

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TRIPP: It was later in the evening. I was in the reception area. The door to Bernie's office was closed. At one point in time, Cliff Sloan came out of Bernie's office and asked me if it was possible to remove one of the typewriters to bring back into Bernie's office.

CHAFEE: And what did you say?

TRIPP: I asked him why it was necessary to try to do that when we had five computers in the outer office.

CHAFEE: And what did he say?

TRIPP: That he wanted the typewriter.

CHAFEE: And so what happened?

TRIPP: Well, we had two typewriters, and I explained to him that the way they were configured and plugged in under all the massive furniture with taping to the carpet and the co-mingling of all the various cable underneath, that it would be a very difficult endeavor, and that I offered to get him a typewriter, excuse me, from elsewhere.

CHAFEE: And what did he say?

TRIPP: He indicated he, that was not something he chose for me to do at that point, and he went back in the office.

CHAFEE: Went back into Mr. Nussbaum's office?

TRIPP: Yes, sir.

CHAFEE: And he closed the door.

TRIPP: He did.

CHAFEE: At that point, was Mr. Nussbaum, were Mr. Nussbaum and Mr. Neuwirth still in Mr. Nussbaum's office?

TRIPP: It was my understanding that those are two others in the office.

CHAFEE: And you're quite sure it was Mr. Sloan who came out that evening and not Mr. Neuwirth?

TRIPP: To the best of my recollection, it was Mr. Sloan.

CHAFEE: Now, I also want to keep your attention, Ms. Gorham, focussed on the same afternoon or evening. After the, you had observed the briefcase being taken out of Mr. Foster's office and the

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various comings and goings, did there come a time that Mr. Nussbaum had asked you to come into his office, either later that day or early the next morning?

GORHAM: Yes.

CHAFEE: Would you tell us about that.

GORHAM: Mr. Bernie, Mr. Nussbaum asked me to sit at the chair on the opposite side of his table and asked me if I had seen anything in the bottom of Vince's briefcase. And I told him that I had only seen the color yellow and I had seen the top of a gold kraft third-cut folder, and that is all I had seen.

CHAFEE: Now when you say a gold kraft third-cut folder, you mean a folder like this, a manila type folder?

GORHAM: Yes, sir.

CHAFEE: And you told Mr. Nussbaum you had seen that in Mr. Foster's briefcase at an earlier time?

MORE

SENATOR ALFONSE D'AMATO
Chairman
Special Senate Whitewater Committee
Washington, D.C.
1995 WL 455181 (F.D.C.H.)
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Citation
141 Cong.Rec. S6771-02
1995 WL 298394 (Cong.Rec.)
(Cite as: 141 Cong. Rec. S6771-02)

Rank(R)
R 3 OF 58

Database
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Mode
Page

Congressional Record --- Senate
Proceedings and Debates of the 104th Congress, First Session
Wednesday, May 17, 1995

***S6771** ESTABLISHING A SPECIAL COMMITTEE TO INVESTIGATE WHITEWATER DEVELOPMENT CORP. AND OTHER MATTERS

Mr. D'AMATO.

Mr. President, I send the resolution to the desk on behalf of myself and Senator DOLE-and I know others would like to join-and I ask for its immediate consideration.

The PRESIDING OFFICER.

The clerk will report.

The bill clerk read as follows:

A resolution (S. Res. 120) establishing a special committee administered by the Committee on Banking, Housing, and Urban Affairs to conduct an investigation involving Whitewater Development Corp., **Madison Guaranty** Savings & Loan Association, Capital Management Services, Inc., the Arkansas Development Finance authority, and other related matters.

The PRESIDING OFFICER.

Is there objection to the immediate consideration of the resolution?

There being no objection, the Senate proceeded to consider the resolution.

Mr. D'AMATO.

Mr. President, Whitewater is a very serious matter. Some questions raised by Whitewater go to the very heart of our democratic system of government. We must determine whether the public trust has been abused. We must ascertain whether purely private interests have been placed above the public trust. The American people have a right to know the full facts about Whitewater and related matters.

After the Banking Committee's hearings last year, many important questions still remain. The American people have a right and a need to know the answers to these questions.

Congress has the responsibility to serve as the public's watchdog. We would be derelict in our duties if we did not pursue these Whitewater questions. The Senate must proceed in an evenhanded, impartial, and thorough manner. We have a constitutional responsibility to resolve these issues.

Mr. President, we now bring before the Senate a resolution that authorizes a special committee administered by the Banking Committee to continue the Whitewater inquiry that was started but not completed during the last Congress.

I thank my distinguished colleague, Senator SARBANES, for his hard work and cooperation in the preparation of this resolution. We have jointly prepared a resolution that is balanced and fair and that will allow the special committee to search for the truth. I am confident that Senator SARBANES and I will continue the Banking Committee's bipartisan approach to the Whitewater matter.

Mr. President, our pursuit of these questions must be and will be fair, straightforward, and responsible. The American people expect and deserve a thorough inquiry committed to the pursuit of truth. That is the American way.

Last summer, the Banking Committee met these vigorous requirements. Our

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examination of the Whitewater matter was impartial, balanced, and thorough. That is our goal in this Congress. I am confident that we will meet these goals.

During last summer's hearings, many facts were uncovered. We learned that certain top administration officials were not fully candid and forthcoming with the Congress. That is an undisputed fact. The public has a right to expect more from those in positions of trust. We also learned that senior Treasury Department and Clinton White House officials mishandled confidential law enforcement information concerning **Madison Guaranty.** That is another undisputed fact. Madison is now defunct; it is a defunct S&L at the heart of the Whitewater matter. The failure of this Arkansas S&L eventually cost American taxpayers more than $47 million.

Mr. President, the American people have a right to know the answers to ***S6772** many serious questions still remaining about Whitewater and related matters. We have a constitutional obligation to seek the answers to these questions. That is why I am offering this resolution today.

Now I will briefly outline some of the matters that this resolution authorizes the special committee to investigate. We will begin with the handling of the papers in deputy White House counsel Vince Foster's office following his death. Who searched Mr. Foster's office on the night of his death? What were they looking for? What happened to Mr. Foster's papers? Were any papers lost or destroyed? And who authorized the transfer of Mr. Foster's Whitewater file to a closet in the First Family's residence? The public has a right to the answers to these questions.

Mr. President, this resolution encourages the special committee to coordinate its activities with those of the **independent counsel,** Kenneth Starr. Senator SARBANES and I have met with the **independent counsel.** Judge Starr has indicated to us that he has no objection to the special committee's plan to inquire into the handling of Mr. Foster's papers. Senator SARBANES and I are committed to coordinating the committee's activities with those of the special counsel.

This resolution authorizes the special committee to pursue answers to other questions raised during the Banking Committee's hearings last year.

We will explore the scope and impact of the improper dissemination of confidential law enforcement information concerning **Madison Guaranty.** How widely did the Clinton administration officials communicate this confidential information? Did any high-ranking officials inform targets of criminal investigations? If so, did this impact any ongoing investigations? The public has a right to know the answers to these questions.

The special committee will also examine whether there were any improper contacts between the Clinton White House and the Justice Department regarding **Madison Guaranty.**

We know that Paula Casey, the U.S. attorney in Little Rock, declined to pursue criminal referrals involving Madison. That is an undisputed fact. We also know that Webster Hubbell, who has pleaded guilty to mail fraud and tax evasion, was the No. 3 official at the Justice Department at this critical time. This is another undisputed fact.

The committee will ascertain whether Mr. Hubbell contacted Paula Casey about Madison. And who else, if anyone, knew about these contacts with the U.S. attorney. The public has the right to know.

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Mr. President, this resolution authorizes the special committee to explore whether the Resolution Trust Corporation and other officials in Washington tried to interfere improperly with RTC staff in Kansas City responsible for investigating wrongdoing at Madison. If such interference occurred, who authorized it, and why? The public deserves answers to these questions.

During last summer's hearings, the Banking Committee learned that the Treasury inspector general furnished the Clinton White House, at the White House counsel's request, transcripts of the inspector general's depositions. That is an undisputed fact.

The committee will now look into whether these deposition transcripts were used to coach administration witnesses before they appeared in front of the committee. That would be wrong. The public has a right to know if it happened.

All of these matters that I have discussed so far involve events that occurred after January 1993 when President Clinton took office. There are also serious questions regarding events that occurred in Arkansas in the 1980's when President Clinton was Governor. This resolution also authorizes the special committee to examine these matters. Some of these Arkansas matters are complex and will require the committee's close review of many thousands of pages of documents.

We will review the operations and regulations of **Madison Guaranty.** Did James McDougal, Madison's chairman and Governor Clinton's business partner, improperly divert Madison's funds to himself and others? Did any of this money find its way into the White House real estate project in which McDougal and Governor Clinton were partners? Did McDougal misuse Madison funds to cover any losses the First Family suffered on their Whitewater investment? The public has a right to know the answers to these questions.

Mr. President, the resolution further authorizes the special committee to examine the Rose law firm's representation of both Madison and RTC, and senior partners at the Rose law firm, including Larry Rodham Clinton, Webster Hubbell, and Vince Foster. The committee must ascertain whether the Rose law firm properly handled the RTC civil claims concerning Madison.

Did the firm have a conflict of interest, and did American taxpayers lose money in the process?

We will also examine Capital Management Services and its president, David Hale, a former Arkansas judge and Clinton appointee. Hale has publicly charged that the President pressured him to make Small Business Administration loans that were used to prop up Madison.

Did this happen? Did Hale also make improper Small Business Administration loans to current Arkansas Gov. Jim Guy Tucker?

Then there is the matter of the financing of the 1990 Arkansas gubernatorial campaign. We now know that the president of the Perry County Bank, Neal Ainley, has pleaded guilty to violating Federal laws in connection with the handling of certain large cash transactions for the Clinton campaign. Ainley claims he did so at the direction of campaign officials. The public has a right to know who authorized this activity and why.

Mr. President, this resolution will authorize the special committee to examine these and related matters. We will take every reasonable step to complete this inquiry promptly. We hope that the administration cooperates with us in this regard. But we also intend to be thorough and comprehensive.

This resolution provides $950,000 to fund the special committee through

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February 29, 1996. If additional money is needed, the special committee will make a recommendation not later than January 15, 1996, and the majority and minority will meet to determine the time for any vote.

Mr. President, we expect to hold public hearings into the handling of the papers of Vince Foster's office in late June or early July. We will continue our inquiry by subject matter until it is completed. In doing so, we will make every effort not to interfere with the **independent counsel's** criminal investigation.

Mr. President, the American people deserve to know the full facts about Whitewater and related matters. As I said at the outset, we will conduct this inquiry in a fair, evenhanded, and impartial manner.

That is what the American people want, expect, and deserve. I urge the approval of this resolution.

I see that my distinguished colleague and ranking member, Senator SARBANES, is here. We have allocated up to 2 hours, equally divided.

I yield the floor.

Mr. SARBANES.

Mr. President, may I ask what the time situation is?

The PRESIDING OFFICER (Mrs. HUTCHISON).

There are 2 hours, of which 15 minutes has already been used.

Mr. SARBANES.

There is an hour now remaining on this side?

The PRESIDING OFFICER.

That is correct.

Mr. SARBANES.

I thank the Chair.

Madam President, it is not my intention to use the entire hour. I hope at some point both sides might be able to yield back time and proceed to final consideration of the resolution.

Let me say at the outset that the resolution we are considering today, which authorizes a special committee to be administered by the Committee on Banking, Housing, and Urban Affairs, is really a carrying out of resolutions that were adopted last year by this body. I think it is important to consider this resolution in the context of those resolutions-actions taken by the Senate last year.

On March 17, 1994, a little over a year ago, the Senate adopted a resolution by a vote of 98-0 expressing the sense of the Senate that hearings should be held on all matters relating to Madison, to Whitewater, and to Capital Management.

Then, to carry out that resolution, at least in part, on June 21 of last year, ***S6773** the Senate agreed to Senate Resolution 229, which authorized hearings to be held into certain areas. Those hearings were done last summer. We had 6 days of public hearings. We had extensive analysis of documents that were provided to the inquiry committee in order to enable it to carry out its responsibilities.

Now, one of the things that was authorized to be looked into by the June 21 resolution was the handling of the Foster documents. That was later deferred, in response to a request from the **independent counsel** who contacted the committee and indicated that, given the nature of his inquiry, it would be preferable if the Committee did not go ahead with that hearing. Accordingly, we

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held off.

Now the distinguished chairman has indicated that it would be the first item which will be considered in the hearings that will now take place under the resolution we are considering here today.

So this resolution is in effect a continuation of our earlier work. It authorizes the completion of work specified in last year's resolution, as well as matters developed during and arising out of the hearings that were held last summer, and also a number of matters my colleague has enumerated that carry forth on the sense-of-the-Senate commitment last year to investigate all matters pertaining to Madison.

I want to go through some other aspects of this resolution, just to lay them out on the record. The chairman of the Banking Committee, Senator D'AMATO, has gone through a number of matters that have been provided for in this resolution to be examined by the special committee. The special committee, administered by the Banking Committee, shall consist of all of the members of the Banking Committee plus two members added from the Judiciary Committee. The chairman and ranking members of the Committee on the Judiciary, or their designees, will join with the members of the Banking Committee to constitute the special committee which will be administered by the Banking Committee. So it is essentially-or primarily, let me say-a Banking Committee activity, since most of the areas to be examined clearly fall under the jurisdiction of the Banking Committee. But we did add from the Judiciary Committee last year. A member came on in order to help carry out the inquiry. And there are some matters that are contained in the resolution, to be examined that, it could well be argued, are under the jurisdiction of the Judiciary Committee. So, to bring that together, we are bringing on two members from the Judiciary Committee, the chairman and ranking member or their designees. They will be designating someone else to handle this responsibility if they choose to do so, and I do not know at this point what Chairman HATCH and ranking member BIDEN intend to do in that regard. But obviously we will abide by their decision.

We have also provided in the resolution which is now before us, and which shortly will be adopted, for rules and procedures of this committee which essentially will be the rules and procedures of the Senate, the Standing Rules of the Senate, and the rules of procedure of the Committee on Banking, Housing, and Urban Affairs. That is, in effect, the rules framework, procedural framework within which we will operate. There are in the resolution sections that cover aspects of the process that the special committee will follow; these are matters it was deemed important that we spell out in the resolution how they were going to be dealt with. Those involve questions of subpoena powers, questions of how the hearings will be conducted-important questions about immunity. I want to underscore that because that is a matter we have had to address before.

We provide that to grant a witness immunity-I want to read this section because it is an important matter. The special committee has the power: "To grant a witness immunity under section 6002 and 6005" of title 18, United States Code, "provided that the **independent counsel** has not informed the special committee in writing that immunizing the witness would interfere with the ability of the **independent counsel** successfully to prosecute criminal violations."

We also provide for staffing of the committee. There is power to appoint

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special committee staff including consultants, assistance from the Senate legal counsel, assistance from the Comptroller General. There is a provision whereby the committee can draw on other Government agencies, Government personnel, and on other congressional staff. And we hope, through a combination of all of these sources, that we will have an adequate staff to carry out a proper inquiry and investigation.

There is also, of course, special provision for the protection of confidential information, since we will be interacting with the **independent counsel** and others and we think it is important to have such provisions.

Finally, the money asked for in this resolution, just under $1 million, $950,000, is to cover the salaries and other expenses of the special committee carrying out this inquiry, beginning on the date of the adoption of this resolution-I assume today-and ending February 29, 1996.

If it is judged that additional money is needed, that the inquiry needs to go forward and additional money is required in order to fund it, the special committee will recommend that. Of course there will have to be a further vote for the providing of additional moneys to the special committee.

Mr. President, let me just make a couple of further, more general observations. I have very quickly gone through the resolution and I think most of it is straightforward. I think Members of the Senate upon reviewing it will conclude that is the case. Many of the provisions are what one might call boilerplate for such an inquiry, and track previous provisions that have been used in various Senate resolutions establishing committees to carry out inquiries or investigations of the sort that is being authorized here.

I listened to the chairman with great interest and I was particularly encouraged by his very strong statement of the need to conduct impartial, balanced and thorough hearings, which is exactly what I think needs to be done. There are a lot of allegations that are swirling around and there are a lot of questions that are being raised. We see them from time to time raised in the press and in the media. And, of course, one could sit around all day long and conjure up one question after another. It is not difficult, it is very easy. It is not difficult just simply to say, "Well, suppose this happened or suppose that happened; or if this or if that." Of course, one of the purposes of these hearings is to get a good, tough-minded examination of these various allegations to see if there is anything to them. It needs to be appreciated, that it is very easy to make the allegations. Whether the allegations are in fact substantiated by the facts is a tougher question to determine, and that does require an impartial, balanced and thorough hearing. In fact, the President himself has said the best way to address these matters is to look at the facts candidly, and that is what I very much hope and expect that this committee will be able to do.

I do think last summer we conducted hearings that were perceived by all as being thorough and fair and impartial. We went at it, in effect, to find out what the facts were, to ascertain the truth. I think we pressed that issue in a resolute manner, and I would expect the special committee will do so in the case that is-in the instance that is before us.

These hearings will make an effort to get the facts out fully and impartially. We anticipate that the administration will cooperate with this effort. They certainly have indicated that is what they intend to do. Last year they made every document available that was requested, as I recall. I think I

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am correct in that statement. Now the time has come to move forward, to begin our hearings, to begin, in effect, to examine these various questions and allegations and ascertain with respect to each of them whether there is any factual grounding behind them or whether they simply raise questions that people can ask. And that, of course, is the purpose of the inquiry which we will be undertaking here with this provision of $950,000 to carry out this investigation in the period between now and February 29. The resolution provides that the special committee shall make every reasonable effort to complete, ***S6774** not later than February 1, 1996, the investigation, study, and hearings authorized by section 1.

This resolution does provide the basis for carrying out a full and proper, impartial, and balanced hearing.

I think our challenge now is to move ahead in carrying out our responsibilities in the special committee. It is a heavy burden to add to the responsibilities that Members already have but is one that obviously we are charged with responding to.

As I said, we adopted resolutions last year addressing this matter. This, in effect, carries forward on those resolutions. It is a continuation, in effect, of that work. But I hope that if we apply ourselves to it over the coming months, we will be able to work through all of these matters and, in effect, bring this issue to closure in the sense that the Members of the Senate and the American people know that the various questions have been raised and thoroughly examined, that it has been done with a great deal of balance and fairness and impartiality, and that these are what the facts are as a consequence of that investigation and inquiry.

Madam President, I yield the floor.

Madam President, I suggest the absence of a quorum. Will time be equally charged?

The PRESIDING OFFICER.

Only by unanimous consent.

Mr. SARBANES.

I ask unanimous consent to put in a quorum call and that the time be equally charged to both sides.

The PRESIDING OFFICER.

Is there objection? Hearing none, it is so ordered. The time will be charged to both sides equally.

The clerk will call the roll.

The assistant legislative clerk proceeded to call the roll.

Mr. FAIRCLOTH.

Madam President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER.

Without objection, it is so ordered.

Mr. FAIRCLOTH addressed the Chair.

The PRESIDING OFFICER.

Who yields time to the Senator from North Carolina?

Mr. D'AMATO.

I yield to the Senator from North Carolina whatever time he needs, Madam President.

The PRESIDING OFFICER.

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The Senator from North Carolina is recognized.

Mr. FAIRCLOTH.

Madam President, I want to begin my remarks by saying that I plan to enthusiastically support the Whitewater resolution.

I think it is a good resolution. I am concerned, however, that a few key things have been left out of it. Nevertheless, I think that before the hearings are over, we will wind up working them in.

Nothing in this resolution allows us to probe the circumstances surrounding the death of Vince Foster. When we held the hearings last year in the Senate, a key witness, Captain Hume, simply did not show up at the hearings the day he was supposed to be there. The hearings had been planned for months. Captain Hume was out of town that day. He was supposed to be there. Our ranking member at the time demanded that they bring him back for several days. But they did not bring him back. The hearings adjourned and we never heard from him. I do not think this was a thorough airing of the issues, and I think we need to do it again.

I understand that Mr. Starr is looking at this again. I hope that he will, given the miserable job that Mr. Fiske did of investigating.

Madam President, the Congress also needs to probe the $100,000 profit in the commodities market that came to Mrs. Clinton courtesy of Red Bond and Jim Blair, the general counsel of Tyson Foods. This is not mentioned in the resolution, and it should be.

Just recently, I discovered that a friend of the Clintons, Barbara Holum, was conveniently installed as acting head of the CFTC before the story of Mrs. Clinton's commodity trades broke.

There are many confusing issues. Now we find that Red Bond, who did the commodity trading, who is practically bankrupt, was able to pay off $7 million in back taxes just 2 months before the commodity trading story became public. To me, the evidence on this is just too much to believe that all of this is a coincidence.

Madam President, this resolution does not allow us to probe the failure of First American Savings & Loan in Illinois.

If you can believe this, Vince Foster and Mrs. Clinton were hired by the Federal Government to sue Dan Lasater. The same Dan Lasater that was a close friend of the Clintons. That is right, Mrs. Clinton was hired by the Federal Government to sue Dan Lasater in connection with the failure of First American Savings & Loan in Illinois. Mrs. Clinton participated in the decision to lower the amount of money the Government would recover from Dan Lasater from $3.3 million to $200,000, and we do not know yet what percentage of that went to her as attorney's fee because the records were sealed.

The Government spent over $100 billion to resolve the savings and loan crisis. With crooks like Dan Lasater involved and with Mrs. Clinton acting on behalf of the taxpayers, suing a friend, it is no wonder the cost was so high.

I want to again state my strong support-and I say this not necessarily in the language as we often use in the Senate-but of my good friend, fellow member of the Banking Committee and our chairman, ALFONSE D'AMATO. He truly is a good friend, and he has given us the leadership we need.

I hope, and I know that before this hearing is over, under his leadership, we will have probed all aspects of Whitewater in a fair manner so that the American people understand what happened, when it happened, and who knew it

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when it happened. I look forward to the hearings.
Mr. D'AMATO addressed the Chair.

The PRESIDING OFFICER.
The Senator from New York is recognized.
Mr. D'AMATO.
Madam President, I know of my good friend, Senator FAIRCLOTH's concern that there be ample scope to look into all of the matters that are relevant, and I share that concern. I think that this resolution very fairly embodies us with the authority-and I would refer to page 4.
As my friend raises, we did not attempt to spell out every single area. Page 4, line 12, says:
Subsection 3. To conduct an investigation and public hearings into and study all matters that have any tendency to reveal the full facts about . . .
Then we go through all of the various areas. There are other Senators who are going to speak, but I believe it is important to summarize those areas. Senator SARBANES has. The fact is that we include the ability to look into the bond underwriting contracts between the Arkansas Development Finance Authority and Lasater & Co., and all of those activities to which my friend has referred. But there must be a connection, and if there is a connection, well, then, we will look into the area, and I will touch on these areas in more detail before our time is up.
So I share my friend's concern. This will be thorough. It will be thoughtful. And when subpoenas are issued-and I must tell you that the specific instance that he raises is troubling, that of a witness who failed to respond to a subpoena, especially one who works for the Government, who was given notice, and who gave the committee, either the majority or the minority or our staff, no reason to believe that he would not be there. That will not be tolerated. If we run into a situation like that, I can assure you, and I know that the ranking member shares this same concern, we want people to respond to subpoenas. We will not issue them frivolously.
I think in that case a subpoena might not have even been issued because we assumed that he was going to be there. So it is not a bad track record to have almost everybody respond, including even those who were not subpoenaed. But, we will remain vigilant in seeking this kind of cooperation.
I see that Senator BOND is in the Chamber, and he is on the Banking Committee and was an integral part of last year's hearings, and I yield to him 10 minutes from my time.
The PRESIDING OFFICER.
The Senator from Missouri is recognized.
Mr. BOND.
Madam President, I thank my good friend, my colleague from New York.
Madam President, as we begin the debate on this resolution authorizing a second round of Whitewater hearings, I thought it would be helpful to review why the Senate and the committee need these issues to be aired.
***S6775** I wish to summarize for my colleagues some points that are particularly important to me and have come from my experience with the first round of hearings and also with the hearing back in February where we asked the questions that began some of the process in finding out what has gone on in the administration.

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As most of the Nation now knows, **Madison Guaranty** was a Little Rock savings and loan which went belly-up at the cost of nearly $50 million, and was owned by James McDougal-the business partner of the Clintons' in the Whitewater real estate deal.

Madison Guaranty was the classic S&L story of insider dealing, reckless loan policies and ultimate failure with the U.S. taxpayers picking up the tab. It is a part of the $105 billion cost of the S&L debacle, and in that way is a story repeated in many communities around the country.

But one part of this case has made it famous-many of its borrowers, directors, and counsel were prominent figures in Arkansas politics and government.

The tangled web of Madison, Jim McDougal, and the Clintons has led to two sets of criminal referrals, an ongoing civil liability investigation by the RTC, a potential conflict of interest case for the First Lady's former law firm, a conviction of a Little Rock judge who improperly loaned SBA money to McDougal and Whitewater, several other recent guilty plea agreements and an ongoing investigation by **independent counsel** Starr.

Since these issues first came to light, I have said over and over that the American people have a right to know what happened to the millions of dollars lost, and we, in Congress, must fulfill our obligation and get the facts out into the open.

Last year the Senate was engaged in a lengthy struggle over what questions and areas the Banking Committee would be allowed to address as Whitewater-Madison hearings begin. Unfortunately, the Democratic leadership at that time did everything in their power to limit the scope of the hearings, and to block our efforts to get at the truth-particularly as it relates to what Clinton administration officials have done to control or interfere with investigations.

The questions we asked last year remain as relevant today as they did last May:

Did Whitewater Development Corp. benefit from taxpayers insuring of **Madison Guaranty** deposits?

Did any of Madison's federally insured funds go to benefit the Clinton campaigns?

Were the bank regulatory agencies operating in an impartial and independent manner as they handled **Madison Guaranty?**

How did the Resolution Trust Corporation handle the criminal referrals on Madison-both under the Bush administration as well as the Clinton administration?

How did the Resolution Trust Corporation and the FDIC handle potential civil claims against Madison-both under the Bush administration as well as the Clinton administration?

How did the Department of Justice handle the RTC criminal referrals it received, again both under the Bush administration and the Clinton administration?

What were the sources of funding and lending practices of Capital Management Services, and how did the SBA regulate and supervise it, particularly as it related to loans to Susan McDougal and her company, Master Marketing.

Full hearings on the Whitewater-Madison affair are needed so that all these questions can be fairly asked and answered. What happened in Arkansas, what happened in the 1992 Clinton campaign in their efforts to keep the lid on about

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the actions in Arkansas, and what has the administration done to manage the Madison-Whitewater issues since they took office.

If we are to finally get to the bottom of the story as to what happened with the criminal referrals, I believe that we need to start with the first criminal referral on **Madison Guaranty** which was already in the Justice Department awaiting action when the Clinton administration took office.

Remember, **Madison Guaranty** had failed in 1989 and had been first taken over by the FDIC, and then in August 1989 when Congress passed the S&L bailout bill the newly created RTC took over Madison.

The RTC's mission was to close down failed thrifts, sell the assets, pay off the depositors and then seek out criminal or civil wrongdoing that may have occurred. If they found criminal wrongdoing-fraud, or attempts to enrich, they referred their findings to the Department of Justice for further action.

If they found civil wrongdoing-for example, law firms or accounting firms who helped institutions stay open by providing misleading, incomplete or incorrect information to regulators or the S&L's board members-the RTC would pursue those cases.

Thus from August 1989 the RTC had **Madison Guaranty** on its plate. No action was taken by the RTC on potential civil claims, but several criminal referrals were developed. In one case Jim McDougal and two others were accused of fraud, but were acquitted, in another case a board member plead guilty to falsifying documents.

Then came March 1992 when the New York Times reported a series of potential misdealings in **Madison Guaranty** and spurred the RTC to take another look at the institution. This second look caused the first criminal referral to be sent to Justice in the fall of 1992, and it was this referral which awaited final action when the Clinton administration came into office in January 1993.

I give this brief history in order to put things into perspective. Last year, Senator SPECTER and I offered amendments to the Whitewater Committee resolution which would have allowed the Banking Committee to pick up story at this point, and follow the trail of the first referral as it made its way through the Government, and then to follow the trail of the second referral as it was developed throughout 1993, up to and including the improper contacts by Treasury officials with White House staff. This of course would entail questioning the RTC officials involved, Justice Department officials involved, as well as Treasury and White House staff.

Because we must remember that on the day that the Clinton administration officials walked in the door on January 21, 1993, a criminal referral on **Madison Guaranty** was sitting in the Department of Justice.

I for one still want to know:

How did the Department of Justice handle this referral?

Was the White House informed and if so when and by whom?

Who in Justice was assigned to monitor the Madison case, and what actions did they take?

And then, as we know now, just months after taking office, a second set of referrals was being developed-and it too was sent off to the Clinton Justice Department by RTC officials in Kansas City.

I want to know why the RTC decided to stay on the case. What happened to get a series of RTC officials reassigned and taken off the case? Is there a pattern of special treatment for politically sensitive cases? And again, how did the

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Department of Justice handle the second referral?

I want to know why did the Clinton appointed Little Rock U.S. attorney Paula Casey, along with Webb Hubbell, delay their recusals until after the decision not to prosecute Madison was made? I also want to know the details about Paula Casey and Webb Hubbell's phone contacts during the period when Casey was deciding what to do with the referrals, and did either one of them have any contact with the White House on the referrals at any time?

And now, just in the past weeks we have seen reported by the Associated Press that:

Preparing for televised Whitewater hearings last summer, White House attorneys consulted confidential depositions from a Treasury investigation in an effort to reconcile differing accounts of administration officials who were about to testify.

Former White House counsel Lloyd Cutler acknowledged this week that the depositions were used to identify discrepancies in the recollections of presidential aides before the congressional hearings.

White House lawyers would then "confront" the aides with information they had obtained from the depositions without revealing the sources, he told The Associated Press.

"If we found inconsistencies, we would go back to White House officials, and go back over testimony they gave us," Cutler explained. "and then we would say 'we have heard other reports."'

***S6776** This of course brings into play several other issues which I have been following since the close of the hearings last August. As we know now, confidential information was again turned over by Treasury to the White House-this time under the guise of a Treasury Department inspector general's investigation.

This calls into question not only the independence of the IG, but also the willingness of this administration to politicize what is supposed to be an internal watchdog.

It also calls into question the entire testimony offered by White House officials before the Senate Banking Committee-as they were given another heads up in order to best tailor their testimony to help the boss.

Last November I wrote to then Chairman Riegle and ranking member D'AMATO about what I had discovered. In my letter I stated:

As you know, over these past several months I have continued my efforts to resolve outstanding questions which were raised during the Banking Committee's Whitewater hearings. Initially I became concerned upon discovering during our hearings that the Treasury Inspector General had turned over to the White House-at Lloyd Cutler's specific request-transcripts of all the testimony taken by the investigators a full week before the Office of Government Ethics (OGE) report was made public. At the time we learned this, several former Inspectors General expressed amazement at this unprecedented action. However, no further review of the incident was undertaken.

During my investigation of this disclosure, I discovered that not only were the documents released to the White House at the specific request of White House Counsel Lloyd Cutler, but, in doing so, the Treasury turned over confidential RTC information to the White House.

On Saturday, July 23, 1994, the Department of the Treasury gave the White House all of the sworn depositions of Treasury, White House, and RTC personnel.

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These depositions were unedited.

According to the RTC, it was not until July 26 or 27 that the RTC became aware of the fact that RTC depositions had been provided to the White House.

July 26, after reviewing the information provided by the Treasury I.G., Lloyd Cutler testified before the House Banking Committee.

July 28 and 29, Counsel to the RTC Inspector General Patricia Black redacted all the Treasury, RTC, and White House depositions in order to remove confidential RTC information.

July 31 the OGE report, with edited testimony, was provided to Congress and subsequently made public.

Given that the focus of our hearings this past August was the improper transmittal of confidential information from the RTC to the White House regarding **Madison Guaranty** and the Clintons, I must tell you I am appalled that the same Treasury Department, acting under specific direction from Secretary Bentsen, would again provide nonpublic information about the **Madison Guaranty** case directly to the White House.

In addition, I found it extraordinary that the White House, which was itself under investigation, would be given nonpublic information prior to Congressional hearings-particularly when Congress itself was not given the information.

And now of course we have discovered that Mr. Cutler and others used this information not only to assist in the drafting of Mr. Cutler's testimony-but to help White House staff with the inconsistencies in their own stories.

I find this entire episode just another example of the extraordinary lengths the White House was willing to go to keep the facts from Congress, keep the facts from the American people, and ultimately to protect the administration.

As I have said on this floor before, breaching the public trust is as serious an offense as committing a crime, or being found liable for financial penalties. Governments in free societies have a fundamental pact with the governed. In exchange for the powers and responsibilities which is given the Government, the people expect fairness, evenhanded justice, impartiality, and they held the innate belief that those in power can be trusted to be good stewards of their power.

Our form of democracy relies on checks and balances to keep too much power from ending up in just one place-and Congress, as the people's closest link to their Government has the responsibility to keep a sharp eye out for abuses and breaches of the people's trust.

Thus every Member of Congress takes an oath of office, to uphold the Constitution-and certainly part of that duty to be ever watchful for abuses of power. Interestingly, and not surprisingly, it nearly always falls to the party out of power to be the more diligent in watching out for abuses.

No one disputes this.

But one other fact should also be noted. As important it is for the general public to believe in and trust that their elected leaders are performing their jobs in an ethical, truthful, and fair manner-we, in Congress, must also believe that those in high positions of responsibility are telling us the truth. When we ask questions or make inquiries we must trust that administrations will tell the truth, will be honest, and that when we get an answer, it is a full and complete one.

Unfortunately, Madam President, it is this standard that inevitably some

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administration officials seem unable to comprehend.

Instead of cooperation and truthfulness we have seen evasions, omissions, misstatements, and possibly outright lies.

And the story of potential abuse of the public trust, the politicization of independent agencies and investigations, the use of confidential material for political gain-it only seems to get worse the deeper you look.

Madam President, the next rounds of hearings will go a long way toward clearing the air, and I commend the chairman of the Banking Committee for brining this matter back into the public eye.

I reserve the remainder of my time and I yield the floor.

Mr. DODD addressed the Chair.

The PRESIDING OFFICER.

Who yields time?

Mr. SARBANES.

Madam President, I yield 5 minutes to the distinguished Senator from Connecticut.

The PRESIDING OFFICER.

The Senator from Connecticut is recognized for 5 minutes.

Mr. DODD.

Thank you, Madam President, and I thank my colleague from Maryland.

Madam President, let me begin these brief remarks by commending our colleagues from New York and Maryland for what I think is a very fair and balanced resolution. Obviously, matters such as this are a source of deep controversy and can get out of hand. The fact that they have presented us with a resolution that is balanced and fair is a credit to both the Senator from Maryland and the Senator from New York. Any discussion of this ought to begin with an expression of appreciation on the part of all of us in this body, particularly those of us who will serve on the special committee and who will be working during this calendar year to carry out the mandates and requirements of this resolution. Now I would like to make a few brief observations about the resolution.

As my colleagues know, Madam President, there was a vote by 98 to 0 on March 17 of last year to look into these matters, and what we are talking about here is a continuation of that process. This resolution is simply another step in a process designed to help the American public know the facts about Whitewater.

Second, I would like to point out, Madam President, that the President has fully cooperated in this process. We ought to commend him for this unprecedented level of cooperation.

Many of us recall other Presidents who, when confronted with similar situations, have clogged up the courts of this land, fighting everything along the way. This administration has not done that. In fact, the administration has been entirely forthcoming.

As we discuss these matters, it is important to make it clear that, unlike previous situations where there was a constant conflict between the executive branch and the legislative branch over documents and testimony, that has not been the case here. The administration has complied with every document request, answered every question that has been submitted to it, and I am confident is ready and willing to cooperate in this second stage of the proceeding.

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I think that is an important point to make because, as we look down the road, there is the potential for a prolonged and nasty conflict between the executive and legislative branch.

Third, Madam President, I think last year's hearings, despite moments of passion and emotion, were credible and fair. I think it is important to point out and to state emphatically that it was the conclusion of the committee ***S6777** last year that there had been no violation of criminal statutes or ethical standards.

Of course, individual Members may have their own particular opinions on those matters, and certainly that is their right. But, as a conclusion of the committee, let me restate, Madam President, there were no violations of any criminal statute or any ethical standards. That was the conclusion of last year's hearings.

Now we are going to go to a second phase. I have listened to some who are suggesting that there must have been some wrongdoing, or, even worse, they have already reached the conclusion that there was wrongdoing. Quite simply, that is inappropriate. The purpose of the hearings is to determine whether there was wrongdoing-we must not prejudge the matter.

We do not want to end up appearing like that famous character from the West, Judge Roy Bean. Everyone will remember Judge Roy Bean. He used to say, "We'll hang 'em first and try 'em later."

Sometimes that can happen in congressional proceedings, and I know it is not the intention of anyone on the committee to have that be the case.

So let us avoid partisan wrangling and get the facts on the table. Now the presumption of innocence may not apply to congressional hearings in the same way as in our court system, but there ought to at least be an effort to fully consider matters, and let people have their say, before we reach any conclusions.

Last year, the Senate held thorough hearings, as I mentioned earlier. The committee heard from 30 witnesses, generating 2,600 pages of testimony; 38 witnesses were deposed, generating some 7,000 additional pages of testimony.

It is very difficult to sort through that much material and I want to thank the staff for the work they did. That was a herculean effort. Both the majority and minority staff had to work extremely long hours on this matter, Madam President, and they deserve our appreciation.

Obviously, Madam President, the Senate's integrity and credibility are at stake. The American public has a right to know the facts about Whitewater and the Senate has a constitutional obligation to see that they do.

Last year, the facts were presented fully and impartially. That must be our goal this year. The public, in my view, is fed up with the partisanship that seems to cloud every issue.

As we go through this process, I urge my colleagues to avoid that partisan pitfall. Because we are entering a presidential campaign cycle, that may be difficult for some. But we must all try. The President is sadly correct, and I suspect most of my colleagues, regardless of their political persuasion, would agree when he says that the politics of personal attack are alive and well. I agree with the President that the best way to put this matter behind us is to address the facts candidly.

Madam President, I ask for 2 additional minutes.

Mr. SARBANES.

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I yield whatever time the Senator requires.

Mr. DODD.

I thank my colleague. I will wrap this up.

Madam President, the public wants us to present the facts impartially, come to our conclusions and then move on. And it bears repeating that after going through such a process last year, the Banking Committee concluded that there had been no violation of criminal statutes or ethical standards.

During this next stage, we must not get into political diversions and drag this thing out. The American people want us to get on with the business of creating jobs and expanding economic opportunity, of dealing with health care issues and education. They want us to tackle the hard problems that they face every day.

I think it was there sense of frustration with politics as usual, more than anything else, that created the changes in the Congress. We now have a Republican leadership, and every committee is chaired by that party. They now have an even greater responsibility to the public. They must elevate the good of the nation above politics and I hope that they will do so in proceeding with this matter.

Once again, I commend Senator D'AMATO and Senator SARBANES for putting together a fair resolution and for stating their determination to wrap this matter up by February of next year. I hope we can stick to that schedule and finish this job efficiently.

Finally, while the subject of the **independent counsel** statute is not the subject of this particular resolution, Madam President, I want to suggest that we revisit that legislation as soon as we can.

The idea of appointing an **independent counsel** was to keep politics out of these issues. Unfortunately, it seems that the statute may invite fishing expeditions. We need to be very careful about spending the taxpayers dollars in this way. Otherwise we will have some questionable expenditures. I was told the other day that someone was looking at a witnesses' grade school and high school transcripts. I hope that report is inaccurate because there is just no way to justify that kind of expenditure.

There is the potential for an **independent counsel** to run wild and we need to carefully monitor these matters. I caution those who would like to use **independent counsels** for political gain-regardless of whether it was a previous administration or this administration-that whatever goes around comes around. We would be well advised, in my view, to take a hard look at how some of these operations are being run.

Of course, Congress spends a great deal of money on these investigations. The Banking Committee spent about $400,000 last year, and this resolution authorizes another $950,000. But even that amount is only a fraction of what the **independent counsel** is spending. We are looking at almost $10 million spent by the **independent counsel** and that is just the beginning of it. That figure will go higher.

Of course, the Federal Government must investigate serious accusations of wrongdoing to maintain the public trust. But when it appears there are more Federal agents operating in Little Rock than there are in high-crime areas in certain parts of our country, then one ought to pause and look carefully at what we are doing.

Again, I know that the **independent counsel** statute is not the subject of

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this resolution. I do not want to inject a whole new subject of debate. But I think we ought to take another look at that law and make sure it is operating properly.

Again, I commend the chairman of the Banking Committee, my friend from New York, Senator D'AMATO, and my colleague and friend from Maryland, Senator SARBANES, for the fine job they have done in working out this resolution. We have a very difficult job in front of us. Hopefully, we will conduct our work thoroughly, fairly, and promptly, and in a manner that brings credit to this great body. I look forward to the effort.

Several Senators addressed the Chair.

The PRESIDING OFFICER.

The Senator from New York.

Mr. D'AMATO.

Madam President, at this time, I ask for the yeas and nays.

The PRESIDING OFFICER.

Is there a sufficient second?

There is a sufficient second.

The yeas and nays were ordered.

Mr. D'AMATO.

I yield to the Senator from Pennsylvania 10 minutes.

The PRESIDING OFFICER.

The Senator from Pennsylvania has 10 minutes.

Mr. SPECTER.

Madam President, I thank the distinguished chairman for yielding me this time. I support the resolution and commend the chairman and the ranking member of the Banking Committee for presenting a resolution which I understand will have wide bipartisan support.

I believe it is important to have a congressional inquiry on this in the broad terms which are described in the resolution. It is with some regret, I note, that it has taken us more than a year to get to this point. But it is better late than never, and these are matters where congressional oversight is important.

I recognize the sensitivity of a congressional inquiry on a matter which is being handled by an **independent counsel,** also known as the special prosecutor. But the functions are very, very different where you have an investigation which is handled through grand jury proceedings which are secret and which are directed at indictments. I know that field with some detail, having been a district attorney myself and ***S6778** having run grand jury investigations. That is very, very different from a congressional inquiry where we are inquiring into matters in the public record for the public to see what is going on in Government with a view to legislative changes.

The thrust and focus are entirely different between a grand jury investigation conducted by **independent counsel** and a congressional inquiry which will be handled through the Banking Committee. I am glad to see that the composition of the committee will be expanded to include the chairman and ranking member of the Judiciary Committee, or their designees.

Madam President, the issues involved here have long been a concern of many of us in this Chamber, and I refer to statements which I made last year dated March 17, June 9, June 16, and June 21. I will not incorporate them because that would unduly burden the RECORD, but a good many of my thoughts were

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expressed last year on the matter.

I was particularly concerned about issues involving the RTC as to their inclusion, which was not handled last year, and I am glad to see that the Resolution Trust Corporation is included in the scope of the inquiry which we are about to undertake.

This matter was one that I focused on when we had an oversight hearing on the Department of Justice on July 28 of last year, and I ask unanimous consent, Madam President, that a number of documents be printed in the RECORD which have not been made a part of the RECORD heretofore: My letter dated July 26, 1994, to Attorney General Reno; the attachment of a list of documents which I had wanted to inquire into during the proceedings before the Judiciary Committee; the response which was made by Robert Fiske, who was then **independent counsel;** and a portion of the transcript dated July 28, 1994 before the Senate Judiciary Committee.

The PRESIDING OFFICER.

Without objection, it is so ordered.

(See exhibit 1.)

Mr. SPECTER.

I thank the Chair.

Madam President, these documents will show on their face concerns which were on the record and which were apparent from such documents: that there were considerable issues to be investigated in the RTC at that time. It is unfortunate, in a sense, that there has been the long delay, because we all know, as a matter of investigative procedure, that leads grow cold and witnesses' memories diminish and that the best investigation is a prompt investigation. But the time factor is something that cannot be altered at this time, and at least now we will have a congressional inquiry which will move forward into these very, very important matters.

I agree with the distinguished Senator from Connecticut when he talks about the presumption of innocence. I think that is indispensable as a matter of fairness to all concerned. But these are questions which need to be answered, and questions do not imply an answer of any sort; they raise issues which ought to be answered. We ought to let the chips fall where they may. And in a Government based on a Constitution which elevates the separation of powers among the Congress in article I, and the executive branch in article II, and the judiciary in article III, the congressional oversight function is a very, very important function. Now, finally, we will be in the context where we will be able to inquire into these matters and to find out what those answers are.

I am confident that there will be a fair, judicious, quality inquiry conducted by the committee, and this resolution is one which I think ought to be supported broadly by the U.S. Senate.

I thank the Chair and yield the floor.

EXHIBIT 1

U.S. SENATE, COMMMITTEE ON THE JUDICIARY, WASHINGTON, DC, JULY 28, 1994

(The following is a partial transcript of the above proceedings)

Senator SPECTER. Thank you, Mr. Chairman. Attorney General Reno, as you

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know, I had intended to ask you questions about the handling by the Department of Justice in the matter involving David Hale in this oversight hearing, and I may be able to cover the principal points of my interest without undue specification, or at least undue specification from your point of view.

At the outset, I would like to put into the record my letter to you dated July 26, 1994, together with the chronology of events and all the attachments which I sent over to you, except for numbers 20 and 21. I may get into 20 and 21. I think the balance have been in the record in one form or another, and even if they haven't I think they are appropriate for the public record.

<The letter referred to follows:>

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC, July 26, 1994.
Hon. JANET RENO,
Attorney General, Department of Justice, Washington, DC.

DEAR ATTORNEY GENERAL RENO: I have just noted that you are scheduled to testify before the Judiciary Committee on Thursday, July 28, at 2:00 p.m. at an oversight hearing.

In that hearing I intend to ask questions on the Justice Department's role in investigations of **Madison Guaranty** and/or "Whitewater." While I have not had access to many of the relevant documents, I have seen a few and am alerting you to those documents which will formulate at least some of the basis for my questions.

Some of the documents are referred to in my floor statement on June 21. Other documents that I may refer to are listed on the attached index.

Sincerely,
ARLEN SPECTER.

Senator SPECTER. I would also want to put into the record the faxed letter from Robert Fiske, **Independent Counsel,** to me, dated July 27, 1994.

<The letter referred to follows:>

U.S. DEPARTMENT OF JUSTICE,
OFFICE OF THE **INDEPENDENT COUNSEL,**
Little Rock, AR, July 27, 1994.
Hon. ARLEN SPECTER,
U.S. Senate, Committee on the Judiciary, Washington, DC.

DEAR SENATOR SPECTER: The Department of Justice has sent over to me a copy of your letter of July 26, 1994 to Attorney General Reno, together with the index of documents enclosed with it.

It is apparent from a review of the documents on that index that they relate to the handling by the Department of Justice of a particular criminal referral from the RTC. Based upon interviews we have had with representatives from the Kansas City Field Office of the RTC, we are currently actively investigating this matter. Accordingly, I would respectfully request that you not go into this subject with the Attorney General at your hearing tomorrow since to do so might prejudice our ongoing investigation. (For similar reasons we request that you not go into the matter referenced by documents #20 and #21.)

We have made a similar request to both the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs which, as you know, are in the process of conducting Whitewater hearings. Both of those Committees have agreed not to go into this

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subject until we have completed our investigation.

Respectfully yours,

ROBERT B. FISKE, Jr.,

Independent Counsel.

Senator SPECTER. At the outset, I want to say for the record that I do not agree with the deference which the Congress has accorded the **independent counsel** because I believe that Congress has independent status, and at least equal status, if not more important status, on matters of public policy than the criminal prosecutions. But the Senate has decided otherwise as a political matter, in my opinion.

As I reviewed the charter of Mr. Fiske, it seemed to me that questions about oversight on what happened with David Hale were not within his charter, his charter being to investigate matters of possible criminal or civil wrongdoing. I am advised to the contrary on that, and we may get into that in some specificity.

So let me start in an effort to ask the questions in a generalized way, but candidly as they arise on David Hale's matter. I refer to a memorandum from RTC investigator Jean Lewis to Richard Iorio which quotes officials within the Department of Justice, which is why I ask you about this; specifically, Ms. Donna Henneman in the Office of Legal Counsel. Without making anything more specific as to the Hale matter, my question to you as a general matter is, any time a referral comes in to the Department of Justice that would make the Department look bad or has political ramifications, it goes to the Attorney General. Is that true?

Attorney General RENO. I don't know whether any time something comes in to the Department that would make the Department look bad it comes to the Attorney General.

Senator SPECTER. Well, if you don't know, who does, Attorney General Reno?

Attorney General RENO. I would suspect that each one of the 95,000 people who hear something that might make the Department look bad. I think your question is a little bit broad. I cannot answer it. As I have tried to say from the very beginning, when I appointed Mr. Fiske I tried to make sure that he was as independent as possible. I have continued to try to do that, and I think the ***S6779** worst thing that I could do would be to comment or talk about matters that he is pursuing. I should be happy, because I have great respect for the Senate and for you, at the conclusion of the matter to try to respond to anything, including the specifics.

Senator SPECTER. Well, I don't think that is sufficient, Attorney General Reno, because I think this is a legitimate matter for Judiciary Committee oversight, and we don't have very much of it. But I accept your point that my question was too general, so I will be specific.

The investigator, L. Jean Lewis, of RTC, had many conversations with representatives of the Department of Justice, as reflected in the number of the memoranda which I sent on to you. So if it is too general as to whether any time a referral comes in that would make the Department look bad or has political ramifications it goes to the Attorney General, I would ask you, were you personally informed about the referral from the RTC on the check kiting case involving **Madison Guaranty?**

Attorney General RENO. As I indicated to you, Senator, I made a determination when I appointed Mr. Fiske that I would not comment or make any

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comment. He has expressed to you that he would prefer that I not comment on the specific matters. I do not want to do anything that would impair has independence. I do think you have an oversight function with respect to the Department of Justice, and when it would be appropriate for me to comment I would look forward to the opportunity to do so.

Senator SPECTER. Well, tell me, Attorney General Reno, has would it impair Mr. Fiske's investigation or prosecution for you to answer a question as to whether you had personal knowledge of a referral to the Department of Justice?

Attorney General RENO. I can't tell you, sir, because I have tried to do everything in my power to make sure that Mr. Fiske's investigation is independent and I don't know what his investigation involves. Therefore, I am not going to say anything that could possibly interfere with his investigation.

Senator SPECTER. Well, my question to you is how could it possibly interfere with his investigation to answer a question as to when you had knowledge of a referral to the United States Department of Justice.

Attorney General RENO. I don't know, sir, because I am not going to take the chance of interfering with it. You would have to ask Mr. Fiske because I don't want to do anything at this time that would interfere or impair that investigation. I do not know the nature of the process of that investigation and it would be inappropriate for me to comment, but I do--

The CHAIRMAN. Put another way, Senator, how would it shed any light in this oversight if the Attorney General answered that question? What the hell difference does it make now?

Senator SPECTER. Well, the hell difference that it makes now is on an earlier question which I asked that whenever there is a matter with political ramifications that it goes to the Attorney General-and I asked that question in its broadest terms and was told that it was too general, so that is when I came back to the specific question.

The CHAIRMAN. Let me ask the question the other way to the Senator. Mr. Fiske's investigation in this matter is likely to be wrapped up. He has been moving expeditiously. Does it matter to the Senator whether or not the Attorney General speaks to this issue today or in two weeks or a month, or whenever it is when Mr. Fiske settles this part of his investigation? I don't know when he is going to settle that, but I mean he has been moving very rapidly.

In terms of oversight for next year's budget and last year's actions, it seems to me the Senator would have plenty of time to ask these questions as it would impact on the outcome of the Senator's view as to what the Attorney General should or shouldn't do in the future.

Senator SPECTER. Well, I would be glad to respond to the chairman. It does make a difference to me, and it makes a difference to me because this is an oversight hearing and the request to the committee chairman to have oversight on these matters was declined. There has been a charter which is very, very narrow before the Banking Committee, and this does not involve, to my knowledge, a matter which is within the charter of Mr. Fiske until when I sent a letter to the Attorney General, I suddenly find a reply from Mr. Fiske.

I had two detailed conversations with Mr. Fiske, the thrust of which-and I would be glad to detail them-led me to the conclusion that there was absolutely no interference with the criminal prosecution, a subject that I have had some experience with.

So when I asked the Attorney General a question as to when she has knowledge

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of a referral, I can't conceive that it interferes with an investigation, and that is why I am asking an experienced prosecutor who is now the Attorney General how could it conceivably interfere with a pending investigation.

Attorney General RENO. An experienced prosecutor, Senator, doesn't comment about something that she doesn't know about. I don't know about the details of Mr. Fiske's investigation. But if Mr. Fiske doesn't have any problem with it, what I would suggest that we do is prepare the questions, submit them to Mr. Fiske. If he has no objection to my answering them, then we will try to answer them because I honor your oversight function and I would want to be able to honor that and to not interfere with Mr. Fiske's investigation.

Senator SPECTER. Attorney General Reno, I did not say that Mr. Fiske did not have a problem. He specifically told me that he would like the field to be totally left alone. What I said to you was that after talking to Mr. Fiske, I had no doubt that these questions were appropriate, in my judgment, on oversight by the Judiciary Committee.

Let me ask you this, Attorney General Reno. In terms of the charter that Mr. Fiske has about investigating matters which may involve a violation of the criminal or civil law, is the handling by the Department of Justice of David Hale's matter something that falls within that charter?

Attorney General RENO. I have tried to, again, let Mr. Fiske define that based on the charter that we described so that I would not in any way impair his independence.

Senator SPECTER. Well, do you have any interest in whether any current employees of the Department of Justice are subject to an investigation which might be within Mr. Fiske's charter for possible criminal wrongdoings?

Attorney General RENO. Yes.

Senator SPECTER. Well, if that were so, would you have a duty as the head of the Department of Justice to take some action on those matters before a long investigation was concluded?

Attorney General RENO. It depends on what they are, sir.

Senator SPECTER. Well, suppose they were obstruction of justice?

Attorney General RENO. It depends on the nature of the facts and the circumstances, sir

Senator SPECTER. Well, do you know anything about that on the Hale matter?

Attorney General RENO. Again, sir, I can't comment on the Hale matter.

Senator SPECTER. I am not asking you to comment on the Hale matter. I am asking you whether you know anything about the Hale matter.

Attorney General RENO. That would be commenting, sir, and what I would suggest, if we want to pursue this, is that you pose the questions and then let's see whether Mr. Fiske thinks that they would in any way interfere with the investigation. I am delighted to answer them if they don't interfere.

Senator SPECTER. Well, I am not going to follow the way you would like me to proceed. I make a judgment as to what I think a Senator ought to do by way of oversight, and if you have a concern about that I am prepared to discuss it with you, but I am not prepared to take your instruction or your suggestion.

The question that I pose on an investigation by Mr. Fiske as **independent counsel** within his charter to investigate crimes, obstruction of justice, within the Department of Justice is not something which bears on anything which could conceivably implicate the underlying facts on what David Hale is doing.

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Is Ms. Paula Casey-I understand that she is, but can you confirm for me that she is still the United States attorney?

Attorney General RENO. Yes, sir, she is.

Senator SPECTER. Is she the subject of a criminal investigation by Mr. Fiske?

Attorney General RENO. You would have to talk to Mr. Fiske.

Senator SPECTER. Do you know whether or not she is the subject of a criminal investigation by Mr. Fiske?

Attorney General RENO. You would have to talk to Mr. Fiske. I have avoided having anything to do with Mr. Fiske's investigation in terms of any information that he may have so that I do not impair his independence.

Senator SPECTER. Would you continue a United States attorney operating actively if that United States attorney were the subject of a criminal investigation?

Attorney General RENO. It would depend on the circumstances.

Senator SPECTER. Well, under what circumstances would you terminate such an attorney?

Attorney General RENO. It would depend on the circumstances. Again, you get into a situation of hypotheticals and it is far better that we look at the actual facts, and I would be happy at the appropriate time to do that with you.

Senator SPECTER. Well, Attorney General Reno, I consider your responses, as I see them, totally unsatisfactory, and I consider them totally unsatisfactory because I am not asking you anything about a pending investigation. I am asking you questions as to what came to your knowledge as the Attorney General of the United States Department of Justice.

I am asking you questions about what you know and about what your policy would be if there were charges of criminal wrongdoing, and I don't ask these questions in a vacuum or for no purpose. I ask these questions in the context of having initiated an inquiry on oversight on something which is outside the charter of the **independent counsel.**

The CHAIRMAN. In your opinion, Senator, right, is that correct? In your opinion?

Senator SPECTER. Everything I say is in my opinion. You can add that to everything. I don't speak for anybody but myself, but I do speak independently for myself.

I took a look at an extensive series of correspondence which has gotten to the Department of Justice and gotten to the FBI and gotten to the United States attorney's office and gotten to the executive office and gotten to the Office of Legal Counsel, according to these documents, which I sent to you as soon ***S6780** as I knew there would be this hearing so you would have an opportunity to review them. I promptly advised the chairman as to what I intended to do there would be no surprises about it.

The CHAIRMAN. That is correct.

Senator SPECTER. When I pursue the matter and find I have a telephone call and a letter from the **independent counsel,** I call him and then I am told that it is within his charter, that there is an investigation which is underway for obstruction of justice.

As I review the facts of this matter, I am struck with wonderment as to how officials in the United States attorney's office decline to have immunity granted to David Hale, and then **independent counsel** comes in and in a short

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time has a grant of immunity. Then officials in the United States attorney's office in Little Rock recuse themselves in a later matter, and I wonder how can they recuse themselves in a later matter without having recused themselves in an earlier matter, given their relationship to subjects of the investigation.

I ran a big office myself as a prosecutor, and if I had any reason to believe anybody in my office had any problem, I wouldn't wait for anybody to cleanse it totally and thoroughly and immediately. I do not believe that the charter to the **independent counsel** takes away any of the authority or the responsibility of the Attorney General to act in that circumstance.

In my opinion-everything I say is in my opinion-the questions which I have asked you are entirely appropriate questions, and I give some additional background because I think these are matters which ought to be answered, and I intend to pursue them and I don't intend to wait.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

General, I think you have answered totally appropriately, in my opinion. I think were you to do otherwise, in light of Mr. Fiske's comments, you would be excoriated by Mr. Fiske and anyone else. I guarantee you, you would have an article saying that you have interfered if you went in and, quote, "cleansed," were there a need to cleanse. You would be accused of whitewashing to avoid Mr. Fiske being able to fully look at the matter.

You are answering, in my opinion, totally appropriately, and you have done what I don't know many others have been willing to do. You have said to this committee, without having to have some big show on the floor, that when Mr. Fiske says he is finished with this phase of the investigation you will come back and you will answer questions. It seems to me you are being totally appropriate, but that is why there are Democrats and Republicans, chocolate and vanilla, good and bad, right and wrong, different points of view. Our opinions are different.

I respect this man. He did notify me. Stick to your guns, don't answer his questions, in my opinion.

Senator SPECTER. If I might have just one sentence?

The CHAIRMAN. Yes. You may have more than one sentence.

Senator SPECTER. I don't think this matter has anything to do with good and bad or chocolate and vanilla.

The CHAIRMAN. Well, it may not have to do with good and bad, but it has to do with what one considers to be the appropriate way for you to respond. I think you are responding appropriately because I think you are in the ultimate catch-22 position. At the request of all of us in the Senate, you appointed a Republican named Fiske. Now, the Republican named Fiske tells you, please don't respond to anything having to do with this. You are being asked to respond to something having to do with this, and if you respond or don't respond, you are in deep trouble in the minds of whoever wants to view you as being in trouble. I think you are doing just fine. My view is worth no more, probably a little less in this circumstance, than the Senator from Pennsylvania's, but good job, General.

INDEX

1. RTC Chronology of Criminal Investigation.

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2. Letter of September 1, 1992 from L. Richard Iorio (RTC-KC) to Steve Irons (FBI) transmitting criminal referral.

3. Letter of September 1, 1992 from L. Richard Iorio (RTC-KC) to Charles A. Banks (DOJ) transmitting criminal referral.

4. RTC Internal Memorandum, May 3, 1993. Background remarks and conversation with AUSA Bob Roddey's Office re: **Madison Guaranty** Savings referral.

5. RTC Internal Memorandum, May 19, 1993. Additional conversation with Office of Legal Counsel for U.S. Attorney's U.S. Justice Department, Washington, D.C. No record of Madison criminal referral at Washington DOJ.

6. RTC-KC E-Mail, May 19, 1993. Madison matter forwarded to Donna Henneman in "Legal Counsel." Referral submitted to that office "because of the political ramifications and political motivations."

7. RTC-KC E-Mail, May 26, 1993. Follow-up call from Donna Henneman (DOJ). RTC advised by an FBI agent in Little Rock that it was a 'very solid case of check kiting, and was highly prosecutable." Henneman was growing increasingly frustrated by the situation, because she had seen the information, knew that it had come in, and couldn't understand why she was having such a hard time tracking where the referral and exhibits had gone.

8. RTC-KC E-Mail, June 8, 1993. Conversation with Donna Henneman (DOJ). Madison Referral has reappeared on her desk. Criminal Division has sent memo to Doug Frazier (in Depty. Atty. General Heyman's office) advising him that there was "no identifiable basis for recusal of the U.S. Attorney in the Eastern District of Arkansas." Referral sent to Frazier for review and final decision.

9. RTC-KC E-Mail, June 23, 1993. Conversation with Donna Henneman (DOJ). Package returned from Frazier. Frazier appointed U.S. Attorney in Florida.

10. RTC-KC E-Mail, June 23, 1993. Further conversation with Donna Henneman (DOJ). Spoke with Doug Frazier. Decision made to return the referral back to the Arkansas U.S. Attorney. No basis for recusal.

11. RTC-KC E-Mail, June 29, 1993. Source indicates Madison referral has been returned to Little Rock. Acting U.S. Attorney will not act on referral. It is being held until U.S. Attorney designee Paula Casey takes office.

12. RTC-KC E-Mail, September 23, 1993. Conversation with Donna Henneman (DOJ). Washington DOJ would like to be copied on all future transmittal letters concerning Madison referrals with an additional one paragraph summary of the content of the referrals with the transmittal letters, so that Henneman will be aware of those with "sensitivity issues."

13. RTC-KC E-Mail, September 29, 1993. Conversation with Donna Henneman (DOJ). DOJ would like copies of all future Madison referrals sent to Washington in addition to sending to U.S. Attorney in Little Rock. Henneman will confirm this in writing.

14. RTC-KC E-Mail, September 29, 1993. Conversation with Donna Henneman (DOJ). Washington DOJ withdrawing request for referrals to be sent directly to Washington, but would still like copies of transmittal letters with addendum summary paragraph.

15. RTC-KC E-Mail, October 27, 1993. Conversation with Donna Henneman (DOJ). Inquiry on whether declination letter had arrived from Little Rock U.S. Attorney.

16. Letter of October 27, 1993 from Paula J. Casey (U.S. Attorney) to L. Jean Lewis (RTC). Declination letter on the Madison referral.

17. Letter of November 1, 1993 from L. Jean Lewis (RTC) to Paris J. Casey

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(U.S. Attorney). Confirmation of declination letter and the stipulation from October 27th letter that the matter was concluded prior to the beginning of Paula Casey's tenure and that the RTC had never been advised of such result. Chronology of correspondence between RTC and DOJ.

18. RTC-KC E-Mail, November 15, 1993. Transmittal of white paper outlining chronology of events related to 1992 Madison referral. Challenges news article indicating that decision to decline Madison referral had been prior to Paula Casey's appointment.

19. RTC-KC E-Mail with attachment, January 6, 1994. Discussion of contact with reporter.

20. Letter of September 15, 1993 from Randy Coleman (David Hale Attorney) to Paula Casey. Coleman has been trying to negotiate a plea and senses that Casey is reluctant because of "political senitivity."

21. Letter of September 20, 1993 from Randy Coleman to Michael Johnson. Reiterates interest in plea negotiations, offering David Hale's information and willingness to participate in undercover activities.

Mr. SARBANES.

What is the time situation, Mr. President?

The PRESIDING OFFICER.

The Senator from Maryland has 31 minutes; the Senator from New York has 20 minutes.

Mr. SARBANES.

Mr. President, I yield 10 minutes to the Senator from Arkansas, Senator PRYOR.

Mr. PRYOR.

Mr. President, we have come to a point in this debate when we are about to vote on this particular resolution. If I might, I would like to talk for a few moments about the public's right to know, as the distinguished chairman of the Banking Committee from New York has made reference to.

He says the public has a right to know what happened in the Whitewater matter. The public has a right to know who did what, when, and whatever. I can assure you that the Senator from Arkansas does not disagree.

But I think also the public has a right to know something else. I think the public has a right to know in this case exactly how much money of the taxpayers' dollars we are spending in the so-called Whitewater matter. I think the public has a right to know that with this resolution, if it passes and if the funding goes through-and we all assume it will-the Senate alone will have spent, up through January or maybe February of next year, in the Whitewater matter $1.350 million of Senate money to investigate this matter. I do not have available the amount of money the House of Representatives has spent and will spend in the future. And we do not know exactly how much the cost of the **independent counsel** will be. But here are some figures I might throw out for the RECORD at this time. To the best of our knowledge, Mr. ***S6781** President, thus far, as of August 31. 1994, the **independent counsel,** Mr. Starr and Mr. Fiske, combined, spent $1.879 million. Projected funding for the **independent counsel** for the 1995 fiscal year is $6.3 million, which is a subtotal of $8.129 million, and a total, adding all the figures up, Mr. President, for both the Senate and the **independent counsel** to investigate so-called Whitewater, comes to almost $10 million in taxpayers' dollars.

Mr. President, I think there is something else the public has a right

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to know. I think the public has a right to know that this White House, this President, this First Lady, this administration, has never one time been accused of lack of cooperation. In fact, our President has pointed out, as one of our colleagues has already mentioned, that to be candid and truthful in this matter is going to be the quickest and best way to get to the bottom of it.

In the first round of hearings last summer, the committee heard from 30 witnesses generating 2,600 pages of testimony, deposing 38 witnesses, generating 7,000 pages of testimony.

The administration has produced thousands of pages of documents for committee review. This administration has complied with every document request. They have answered every question posed to it. The administration is ready and willing to cooperate on this second round of hearings and it bears emphasis, I think, that after the long days of hearings and pages of documents reviewed, that the Banking Committee concluded at the end of this hearing, in phase 1, that there had been no violation of a criminal statute and no violation of an ethical standard.

Mr. President, I think, too, it needs to be added that at no time during any of these investigations or any of these hearings, whether it be in Little Rock or Washington, the Banking Committee or the special counsel, wherever, to the best of our knowledge, not one witness, not one person has taken the fifth amendment.

I think that this speaks loudly and clearly about this administration's position, wanting to get on with the important business of our country.

Mr. President, let me compliment our friend, Senator SARBANES, for working out what I think-and going forward with-is a fairly reasonable proposal in trying to attack this problem and to set up these hearings. I think that there are some things, however, that I must state that I do not feel are fair. I do not feel that it is fair for one of the members of the committee, as he did earlier in this debate, to come to the floor and say what should have been within the scope of this hearing and then start talking about those particular issues as if to condemn them, even though they are not in the scope of these particular hearings.

Mr. President, I think for a Senator to come to the floor who is a member of the Banking Committee and to make a statement like he knows for a fact, or he has knowledge that Kenneth Starr, the special counsel, is now going to reinvestigate the death of Vince Foster, I think the public has a right to know how that particular Senator from North Carolina has knowledge of this so-called fact, Mr. President. I think the Senator from North Carolina needs to explain how he knows Mr. Kenneth Starr is now looking or relooking at the death of Vincent Foster.

Mr. President, we hope that these hearings will be fair. We hope they will be soon. We hope that they will be done in a very efficient manner. I am just hoping above all, Mr. President, that in this hearing, these issues are not going to be bogged down in the political morass that we have seen some other hearings conclude with. I would like to say, also, Mr. President, that I think for us to go back to the 1990 Governor's campaign, I think is stretching it a bit. I do not know what that has to do with Whitewater. I think some of my colleagues would like to see us investigate Bill Clinton when he was the attorney general of Arkansas. Maybe we would like to go back to look at his campaign of 1974 when he ran for the U.S. Congress and was defeated. There

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might be some who have no limits on how far back in time we should go.

I hope we can keep our eye on the ball. I am hoping, Mr. President, that we can keep our eye focused on the issue of Whitewater and the particular mission under which carefully this resolution has basically pointed out would be the scope of this particular hearing.

I am also concerned that one of our colleagues has referred to the "the miserable job of Mr. Fiske." Those remarks were made earlier on this floor. Of course, they refer to Mr. Fiske, who was allegedly fired from this investigation as special counsel because he was not finding out enough, bringing forward enough, to satisfy some of our colleagues.

Mr. President, I will conclude once again, as I have done other times on this floor, by quoting a note that Vince Foster wrote. It is his last note. It was his last sentence in this note, when he said "Here"-reference to Washington-"ruining people is considered sport." Those were the words written by the late Vincent Foster.

I am hoping, Mr. President, that when this investigation begins, every person involved with that investigation, from top to bottom, will realize these are human beings; they have families; they have hopes and desires; they have beliefs; and they have reputations. Hopefully, we will not treat lightly those reputations, and hopefully we will make certain that the character and the nature of these hearings seek fairness and justice.

I yield the floor.

Mr. SARBANES.

Mr. President, I yield such time as he may consume to the minority leader.

Mr. DASCHLE.

Mr. President, I thank the ranking member. Let me say, I did not have the opportunity to hear all of his remarks, but let me commend the distinguished Senator from Arkansas for what I have heard him say. Let me associate myself with each and every one of his words. He speaks from the heart, and he certainly speaks for all Members in representing what we hope will be the ultimate goal of this committee as we begin this ever once more.

This resolution provides a sum of $950,000 for the purpose of completing the work on the Whitewater matter. I think it needs to be emphasized again, as we consider the funding, that this resolution includes every issue related to Whitewater that has any credence whatever. There ought not be any question about its work, its scope, and the effort undertaken after today by the Banking Committee.

The funding will expire on February 29 of next year. It is an adequate amount to fund and an ample allowance of time to permit comprehensive and thorough hearings, while providing also for the completion of this issue.

In the 103d Congress, the Senate voted on March 17, 1994, on a bipartisan vote of 8 to 0, to authorize hearings on the Whitewater matter. Senate Resolution 229, adopted in June of last year, authorized a first round of hearings which were subsequently held by the Banking Committee.

The new resolution creates a special committee, administered by the Banking Committee, to conduct the final round of these hearings. The committee will be comprised of the full membership the Banking Committee, with the addition of one Republican and one Democratic member of the Judiciary Committee.

Chairman D'AMATO will also chair this special committee. Senator SARBANES will serve as the ranking member.

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Last year, the Banking Committee heard from a substantial number of witnesses and took thousands of pages of testimony. Last year's hearings were thorough, fair, and bipartisan. They are the model which this year's hearings must emulate.

The majority, which conducted the hearings last year, were fair and judicious in their approach. The new majority in this Senate has the obligation to follow that record in exactly the same manner.

It is important to be thorough and comprehensive, because the American people have a right to know all the facts about this matter; but it is equally important that hearings be fair and responsible. We must all strive to remember and draw the distinction between an unproven allegation and a known, verifiable fact.

What is at stake is the integrity and credibility of the U.S. Senate. The last Senate recognized this by voting unanimously to authorize hearings when questions were raised that deserved examination. This Senate should follow that example.

***S6782** The Senate has the constitutional obligation to see that the facts are brought out. It has the moral obligation to do so fully and impartially. If we do less, we risk reinforcing the unfortunate impression that Senators care more about partisanship than about conducting the Nation's business in the best interests of all the people.

The President has said that in an era of attack politics, the best way to put this matter behind America is to address the facts candidly. He is entirely right.

The administration cooperated fully and extensively with hearings last year and stands ready to do so again this year. Last year, the President ordered his administration to cooperate and all parties did so. Every document request was honored. Every question raised by the committee was answered.

Americans have the right to know the facts of Whitewater. But Americans care about other matters which are also on the Senate agenda a great deal more than they do about this.

Americans are now facing a budget which seeks to dramatically alter Medicare and student aid programs, as well as virtually every other thing the Government does. They are anxious about the future, because so many millions of Americans are either Medicare enrollees or have parents who are Medicare enrollees. They are anxious to see the Senate begin the debate over the budget soon.

Americans expect the Senate to devote the bulk of our efforts to the issues that are of most importance to the majority of American people. I agree. That should be our priority. Today, no issue is more critical than resolving the budget debate.

Mr. President, I urge prompt action on this resolution. I hope it allows for completion of this matter with fairness and impartiality, so that Senators can focus their attention on the issues that deserve it most, the problems facing the American people.

I thank the ranking member for yielding.

Mr. D'AMATO.

Mr. President, I did not mean to unduly delay acting on this resolution, because I think most things that have been said summarize where we are at, what we are attempting to do, and the scope of the investigation and the manner in which we hope to conduct it.

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I think is important to point out that what one of my colleagues, the Senator from North Carolina, Senator FAIRCLOTH, pointed out is a matter of public record. That is that Judge Starr is reexamining all matters reviewed by Special Counsel Fiske, including Vincent Foster's death.

I think he alluded to that, and I think he did so in that context. That is not an area we intend to revisit unless there are some very special circumstances, which I certainly do not envision. However, I think we have to at least put it in that context.

As it relates to what the committee did and did not find last year, I think it is important to note that the Republican minority did make findings on the three major areas where there were questions of misconduct and malfeasance. I will not attempt to enunciate all of them now, but that was a very strong finding.

I would also like to point out that the majority made some findings and recommendations as it related to the need to indicate very clearly that before Congress, all executive branch members and others who testified are "required to be fully candid and forthcoming," and testify "truthfully, accurately, and completely."

The committee recommends that the President issue an Executive order reinforcing this obligation and setting forth procedures requiring the prompt correction, amplification and/or supplementation of congressional testimony to ensure that it is accurate, thorough and completely responsive.

Why did they do that? Without going through the entire history, it was because it was clear and evident-and, by the way, we have sent to Mr. Fiske and to his successor, Mr. Starr, those areas, we being the Republicans on the committee, the minority-that those areas of concern, that, at the very least, there was testimony that was disingenuous, if not outright false. And that is being reviewed.

So, to say that there were no findings of any wrongdoing, that everything was OK, or to imply that there was nothing wrong, is simply an oversimplification and is not an accurate or fair representation of the situation.

Now, I do not intend, nor is it my job and duty, to defend the work of the special counsel. The special counsel was appointed because the Attorney General concluded that it was necessary. It was not this Congress. I thought it was. I believe it was. There were leading Democrats who spoke to the necessity-Senator MOYNIHAN, Senator BRADLEY, and others-as it relates to dealing with this. But as it relates to the expenditures of money, let us look at the record.

This committee, I think, has been very judicious. The Democratic leadership working with Republicans last year authorized $400,000. We only spent $300,000. This year we have set $950,000. I hope we spend less than that. We have been very judicious in using taxpayers' money. So to date we have spent $300,000. Although that is not an inconsequential sum, we have been extremely judicious.

With regard to the expenditures and what has taken place with the special counsel, let me just indicate, first, that David Hale pleaded guilty. He was a municipal judge and has made some extremely serious allegations. The special counsel is reviewing his allegations with respect to why he made certain loans that were illegal or inappropriate, who asked him to do so, and so forth.

Webster Hubbell, the third ranking official in the Attorney General's

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office, pleaded guilty to charges that emanated, again, from this investigation.

Neil Ainley, president of the Perry County Bank, where large sums of money, $180,000, were taken out to fund campaign activities, pleaded guilty.

Chris Wade, a real estate agent who was the sales agent for Whitewater Development, pleaded guilty in a bankruptcy matter. Robert Palmer, last December, a Little Rock real estate appraiser, pleaded guilty to conspiracy charges relating to backdating and falsifying appraisals for **Madison Guaranty.**

I make these remarks because I do not believe that it is fair to leave the impression that this has just been a big waste of time and that there was no wrongdoing. Five individuals, at this early and preliminary stage of these investigations, have already pleaded guilty, some in very high, responsible positions. That is the work of the special counsel. He has to defend the appropriateness of the expenditures which he makes.

However, I think for the record it is fair to reflect that several individuals have pleaded guilty to various charges. As it relates to our work, I am going to reiterate that I believe this committee has properly set forth the venue, the scope and the way in which it intends to move forward in a bipartisan manner to find out the truth and get the facts. Was there an attempt to impede legitimate investigations undertaken at RTC? Why were certain people taken off the case? Why were certain RTC investigators disciplined? Why was information about confidential criminal referrals made public? Was there a failure to go forward? These are legitimate questions. There may be appropriate reasons. But, then again, we might discover inappropriate action.

So these areas are within the scope. We are not going to attempt to dig up something that does not appear to be really connection to the matters that we have set forth. And it is our hope, depending upon the schedule of the special counsel as he goes through the materials, that we can wind this up sooner rather than later, and conduct the business of the people in a manner which reflects credibly on our constitutional obligations as Senators.

Mr. President, I am prepared to yield the remainder of my time. My colleague may have something to do. I am prepared to vote on the resolution.

The PRESIDING OFFICER.

The Senator from Maryland.

Mr. SARBANES.

Mr. President, I will take just a couple of minutes, I say to my distinguished colleague from New York.

First of all, I want to underscore the positive and constructive way in which the chairman of the Banking Committee and members of his staff interacted with us in trying to address the question of working out a resolution that we would bring to the floor of the Senate. Obviously, it is not an easy thing to do, and Members of the Senate have ***S6783** differing views about this matter. But I do think we were able to, in the end, work out a rational approach to this inquiry and investigation, which I indicated in a sense had been committed to last year.

Obviously, you always have to work out carefully the scope questions, which has been done in this resolution, because the scope could be infinite, in a sense, if you leave it to people's imagination. So there were candidates for scope that I think went beyond the horizon, and they are not included. But we have tried to, in effect, put a focus here.

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In fact, some of the questions the distinguished Senator from New York just raised, that he felt emerged out of the previous hearings-and he made reference to last year's minority statement in the report-have in fact been spelled out here as matters that could be looked into under this resolution.

There were other candidates, of course, that were not included. We have tried to be rational here. We have tried to be reasonable. The matters specified herein have been the outcome of that process.

Second, I want to say the resolution has been put together in a way that presumes that the two sides will work together cooperatively in carrying out the inquiry, that the staffs will interact in that fashion, that material will be generally available and so on. We are trying to get an inquiry here in which everyone is joined in trying to find out what the facts are. A lot of questions are raised, and will be looked into. If you did not raise questions, you would not have an inquiry, so I recognize that. But our job, I think, is to probe the factual matter behind those issues.

I was interested that my colleague earlier used the word "allegations," and that is what it is until you actually get the facts that sustain it. And that is the process we are going to engage in. Some things, you know, when you finally examine them, turn out to be fairly innocent. At least I think. We had this point about Captain Hume, who did not appear when he was supposed to be a witness.

Well, what happened-obviously there was a slip-up, but I think that is what it was, a slip-up. Captain Hume was deposed. He had over 300 pages of deposition testimony. Apparently at his deposition he said he was about to take a-go on a vacation. After that the hearing date was set. Everyone sort of assumed that Captain Hume could be brought back in for the hearing. A subpoena, I do not think, was issued for him.

Mr. D'AMATO.

I do not think it was issued.

Mr. SARBANES.

I do not think it was issued for him so he did not, as it were, ignore a subpoena. And he went on a hunting and fishing trip and could not be located, is what happened.

In the end, I think it was judged that given we had 300 pages worth of deposition it was not worth having another hearing simply to bring Captain Hume in. I mean it is a small matter, but I only mention it to show that sometimes when you really examine the facts you discover that something that looked amiss at first has a very simple, plausible, and reasonable explanation for it.

We expect, as I understand it, now to move forward with this. I know that the chairman and his staff will be talking with our staff to begin to plan the first set of hearings which I think will probably be in the next month or so, and then we can proceed from there as we schedule other matters which have been stipulated here in the resolution as being within the scope of the inquiry which this special committee will now undertake.

But I do again want to underscore the, I think, responsible way in which the chairman and members of the staff have worked with us in order to try to frame a resolution which we could bring to the floor of the Senate today which I think carries forward the legitimate requirements imposed upon us in terms of carrying out an investigation without straying beyond what most people regard as reasonable bounds.

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Mr. President, with that, I made my statement. I see the distinguished Senator from Arkansas, and I would like to yield time to him.

Mr. President, how much time is remaining?

The PRESIDING OFFICER.

Ten minutes.

Mr. SARBANES.

Mr. President, I yield 4 minutes to the Senator from Arkansas.

The PRESIDING OFFICER.

The Senator from Arkansas.

Mr. BUMPERS.

Mr. President, I thank the distinguished Senator from Maryland for yielding.

Mr. President, when I was a student in law school I remember studying criminal law. There never had been a lawyer in my family. So I knew nothing about any kind of law. But I remember the professor about the second day said, "Remember, the presumption of innocence is the hallmark of our system of criminal jurisprudence." It is not presumption of guilt.

I asked the question, "Should I defend somebody if they came into my office and told me they were guilty?'

He said that will be a personal call, but you bear one thing in mind. That person may not know whether he or she is guilty under the law. They may think they are and are not.

I am going to vote for this resolution. I have no objection whatever to a fair, open hearing giving everybody a chance to answer the questions of this committee. But I have heard some names thrown around here this morning.

Mr. President, in cases like this, all you have to do is throw out a name. Oftentimes you have destroyed a person or at least destroyed their reputation. And there has been entirely too much of that surrounding this case.

So let me admonish my friends in the U.S. Senate, and especially on this special committee, lawyers and nonlawyers, to ask yourself when you are making some of these speeches and you are throwing out names, why did not this happen, why did not that happen? Well, hindsight is a wonderful thing. But ask yourself when you are throwing names around and wondering whether or not you are destroying that person, a perfectly innocent person for life, you ask yourself this question: "How would you like to be in that somebody's shoes and hear your name bandied around on the floor of the Senate which carries with it the connotation of some wrongdoing or some guilt?"

I hope the Members of this body will rise above that sort of thing, and when they say something and use some of these names in regard to this hearing, make awfully sure they are not destroying some innocent person needlessly and wrongfully.

I look forward to the hearings. I look forward to the people having an opportunity to say what they want to say and answer the questions of the Members of this committee. But for God's sakes do not prejudge everybody that is going to be called as a witness before they get there and have an opportunity to answer the questions.

I yield the floor.

Mr. SARBANES.

Mr. President, I yield 2 minutes to the Senator from Arkansas.

The PRESIDING OFFICER.

The Senator from Arkansas.

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Mr. PRYOR.

Mr. President, I thank the distinguished chairman for yielding me 2 minutes. I had not planned to speak again. But the distinguished chairman of the committee made reference to three or four individuals who have either pled guilty or have been indicted, et cetera. I would like to talk about some of those.

Neil Ainley worked with a bank in Perryville about 50 miles from Little Rock. He pled guilty to four counts, but not one of those counts related to Whitewater; not even close to Whitewater. One was his so-called failure to file with the Internal Revenue Service a withdrawal of cash for the 1990 Clinton campaign; nothing whatsoever to do with Whitewater.

The second individual the distinguished chairman mentioned is Chris Wade. If I am not mistaken, Chris Wade was a real estate broker I believe in Mountain Home near the Whitewater development area. Chris Wade, subsequent to these many years of dealing with the lots at Whitewater, filed bankruptcy; not related to Whitewater in any way. But in the bankruptcy filing he failed to disclose either an asset or a debt. I do not know all the facts but this matter is unrelated, totally unrelated to Whitewater; no relationship whatsoever to the President and Mrs. Clinton. But yet ***S6784** the prosecution has now had him plead guilty.

The third person referred to was Webb Hubbell. We know that case. Webb Hubbell has pled guilty. It is a sad day. He is a good friend. But it was nothing that related to Whitewater Development Corp., absolutely nothing that related to **Madison Guaranty,** nothing whatsoever. Web Hubbell pled guilty to overbilling his clients; nothing to do with the RTC, nothing to do with Whitewater; totally irrelevant.

If we continue spreading this dragnet out further, if we go after every person that has ever had contact with Bill Clinton or Hillary Clinton or James McDougal or whatever, if they have ever made a phone call to them, if they have ever borrowed money or given them a campaign contribution, Lord only knows how long this investigation is going to go. It will go beyond the year 2000.

I just hope that our colleagues on the Banking Committee will realize that we must focus this investigation as it relates to Whitewater and to its original mission.

Mr. President, I thank the distinguished Senator, ranking member, and the distinguished chairman for yielding me this time.

I yield the floor.

Mr. SARBANES.

Mr. President, I am prepared to yield back time.

Mr. D'AMATO.

Mr. President, we yield back the remainder of our time.

The PRESIDING OFFICER.

All time having been yielded, the question is on agreeing to the resolution.

On this question, the yeas and nays have been ordered, and the clerk will call the roll.

Mr. FORD.

I announce that the Senator from Massachusetts <Mr. KENNEDY> is necessarily absent.

The legislative clerk called the roll.

The PRESIDING OFFICER (Mr. SANTORUM)

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. Are there any other Senators in the Chamber who desire to vote?
The result was announced-yeas 96, nays 3, as follows:

<Rollcall Vote No. 171 Leg.>

YEAS-96

Abraham Akaka Ashcroft Baucus Bennett Biden Bond Boxer
Bradley Breaux Brown Bryan Bumpers Burns Byrd Campbell
Chafee Coats Cochran Cohen Conrad Coverdell Craig D'Amato
Daschle DeWine Dodd Dole Domenici Dorgan Exon Faircloth
Feingold Feinstein Ford Frist Gorton Graham Gramm Grams
Grassley Gregg Harkin Hatch Hatfield Heflin Helms
Hollings Hutchison Inhofe Inouye Jeffords Johnston Kassebaum
Kempthorne Kerrey Kerry Kohl Kyl Lautenberg Leahy Levin
Lieberman Lott Lugar Mack McCain McConnell Mikulski
Moseley-Braun Moynihan Murkowski Murray Nickles Nunn Packwood
Pell Pressler Pryor Reid Robb Rockefeller Roth Santorum
Sarbanes Shelby Simpson Smith Snowe Specter Stevens
Thomas Thompson Thurmond Warner Wellstone

NAYS-3

Bingaman Glenn Simon

NOT VOTING-1 Kennedy

So the resolution (S. Res. 120) was agreed to.
Mr. D'AMATO.
Mr. President, I move to reconsider the vote by which the resolution was agreed to.
Mr. SARBANES.
I move to lay that motion on the table.
The motion to lay on the table was agreed to.
Mr. THURMOND addressed the Chair.

The PRESIDING OFFICER.
The Senator from South Carolina.
Mr. THURMOND.
Mr. President, I ask unanimous consent to speak as in morning business.
The PRESIDING OFFICER.
Without objection, it is so ordered.
Mr. THURMOND.
I thank the Chair.
(The remarks of Mr.

THURMOND pertaining to the introduction of S. 812 are located in today's RECORD under "Statements on Introduced Bills and Joint Resolutions.")

Mr. DOLE addressed the Chair.

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