

(1985)

M E M O R A N D U M

July 17, 1985

TO: WAYNE HOWELL

FROM: ORESTES J. MIHALY
DANIEL BELL

Re: E. F. Hutton

On July 12, 1985 Daniel Bell and I met with Albert Murray, Assistant U.S. Attorney for the Middle District of Pennsylvania in Scranton, Pennsylvania. Mr. Murray received authorization from his superiors, the Justice Department, to speak with us. Some of the things he told us were "off the record". Therefore, we would appreciate that this memorandum be kept in the strictest of confidence.

Mr. Murray first of all explained to us the nature of the scheme that was practiced by E.F. Hutton and then went on to offer other comments. The following constitutes some of the statements made by Mr. Murray during the course of the meeting.

1. Murray indicated that Hutton was aware of the state's authority to act upon the felony plea. This was the reason that the felony plea negotiations took such a long time.

2. The practice engaged in was a firm wide practice and the whole firm knew about it.

3. The practice was not a crime prior to Hutton's pleading to it. In other words, this is the first time that such a practice was raised to the level of a criminal practice.

4. He stated that the Congressional committees are just seeking headlines and don't really understand the nature of the

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fraud. He stated that between the media and the politicians the whole thing is really getting out of hand.

5. With regard to Griffin Bell he stated that he thought he was doing a good job. Murray is helping the Bell people and he suggested we should try to piggy-back on Bell's report and not to re-invent the wheel.

6. Murray stated that the state's revocation-suspension power was the sticking point. Hutton was not as much worried of the SEC, but they also believed that the states would follow whatever the SEC's sanction would be.

7. He suggested that we go to the federal District Court in Scranton to obtain certain documents under Rule 11 which would include in camera colloquy on April 31 and May 1, 1985 as well as the transcript of the plea colloquy on May 2. We are in the process of obtaining such documentation.

8. He described Hutton's operations as follows:

a) Hutton is divided in 9 regions and the regions are divided into branch offices. Hutton has a collection system designed to get the money in from the branches to New York as quickly as possible similar to other corporations which have branch offices. Each local branch had a local branch account to receive customers' funds. Each region also had a primary regional bank which serviced the branches. Each branch had a branch manager, a branch cashier and wire operators. Some branches had branch operations managers.

b) Each region had a regional vice president who was also a member of the board of Hutton, a regional operations manager, a regional sales manager and a regional cashier. The regional vice president reported to George Ball or whoever was the president. Murray stated that the regional operations manager rather than the regional vice president really knew what was going on. The regional vice president is more of a policymaking person. He stated that each region had a lot of discretion as to how it was to be run. Hutton was a decentralized operation. The policy was set in New York but carried out in the regions with a great deal of discretion. There was no consistency of policy unless specifically

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directed by New York. Otherwise the policy was carried out by suggestions, etc. The regions were quite autonomous.

9. In New York Tom Lynch was the chief financial officer, Norman Epstein was the head of operations and Richard Gavin was the liaison to the regions. Murray said you would never be able to obtain a clear line of authority. He stated that if Hutton provides us with a corporate personnel chart you might as well throw it out.

10. With respect to the banking activities of Hutton he stated that by virtue of agreements with Hutton the regional banks would allow Hutton to draw money out the next day. The primary bank in New York also had the same agreement. This is called one day availability of funds. This means that Hutton could write the check the next day, draw it out and use it for whatever purposes it saw fit.

11. The local banks ought to have been able to collect the funds overnight. He said that the deposits in a regional bank is the result of a depository transfer check. The DTC is a vehicle for transferring the monies to the prime bank. He said the simplest form of the procedure was to get all the monies into New York as quickly as possible. Assuming that \$3,000 was deposited in a branch from customers' monies, on the same day a check was drawn and deposited in the regional bank and from the regional bank to the prime New York bank. If you freeze the deposits in the particular day's time frame it would appear that there were deposits of \$9,000. Hutton would pull out \$9,000 knowing that there was only \$3,000 in real funds available. In the legitimate system it is presumed that the draw down checks would clear in one day and the deposits in the branch banks would clear in one day. If it takes two days to clear then there is float. If one of these banks cannot clear efficiently, that is, within one day "then a float occurs". Float is the difference in time in the collection of checks. Whatever bank can't clear efficiently loses the interest

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on the float.

12. Hutton's system was a system that tried to obtain the extra deposit in a regional bank or a branch bank which did not clear on time. They would draw down on funds that had not cleared. They believed that any deposit they put in was theirs. If the money remained uncleared in the bank they would draw it out.

13. The government's theory of the criminality is that their theory is flawed. One is not entitled to determine how much profit the bank is entitled to make on a checking account unless it is negotiated with and known to the bank.

14. It was understood by the banks that only customers' funds would be deposited in the branches' banks and the regional banks and primary banks only expected customers' funds to be deposited in the accounts through depository transfer checks. The banks never expected the float withdrawal checks redeposited in these accounts and this was part of the fraud in this case.

15. Hutton stepped over the line when they went beyond the loopholes in the float and created float by multiple transfers, etc.

16. Local banks are less sophisticated and if deposits don't turn over in a day the little bank is paying out before it is collected. Hutton knew this. Hutton knew that the little banks did not tell the difference between a ledger balance (total aggregate of deposits in a bank account), available balance (contractual balance bank makes to you, otherwise known as good funds), and collected balance (checks that are actually collected). Hutton was managing its money on the ledger balance amounts.

17. Cash is zero day money.

18. Hutton would compensate branch managers for not leaving a balance in their checking account.

19. Hutton started to draw down checks for the deposits for a day, plus the anticipated next day's deposits plus, an amount to cover the float, plus a bogus number.

20. The plea was negotiated out of many fraudulent practices that were investigated by Murray. He did not question the remote disbursement system relating to the checks drawn on Bank of America. Murray stated that the books of Hutton are inflated making the company look more profitable. He said to look at their checks and drafts payable on their balance sheet. He said that Hutton did not disclose these various techniques which were in essence borrowings and as any other borrowings should

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be disclosed.

21. Murray said that Hutton did not disclose properly to banks and lied to them. With respect to disclosing to states, they should have disclosed the investigation in 1982.

OJM/DB:dp

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