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Is This The End of Civil RICO?

Randolph N. Jonakait
New York Law School, farrah.nagrampa@nyls.edu

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Is This The End of Civil RICO?

by Randolph N. Jonakait

Sedima, S.P.R.L.
v.
Imrex Co., Inc.
(Docket No. 84-648)

American National Bank and Trust Co. of Chicago
v.
Haroco, Inc.
(Docket No. 84-822)

Both Argued April 17, 1985

While these two cases, argued in succession on the same day, raise seemingly technical questions as to who can sue or be sued civilly under the Racketeer Influenced and Corrupt Organizations Act (RICO) (18 U.S.C. sections 1961-1968), the future of civil RICO is really at stake. As more and more well-established businesses find themselves defendants in civil RICO cases, controversy about the statute has mushroomed. Powerful interests, as indicated by the list of *amici*, will be affected by the outcome of these cases.

Section 1962 of the RICO statute makes it illegal for a person to conduct the affairs, or participate directly or indirectly in the conduct of the affairs, of a business or other enterprise "through a pattern of racketeering activity." RICO defines "racketeering activity" as any act that is "chargeable" as certain serious state felonies or any act that is "indictable" under a list of federal crimes—including the prohibitions on the fraudulent sale of securities and on the use of the telephones and mails in fraudulent activities. In RICO parlance, racketeering activities are called "predicate acts." A "pattern of racketeering activity" requires the commission of at least two predicate acts within a ten-year period. Civil RICO provides that any person injured in business or property "by reason of a violation of section 1962," that is, by reason of a person conducting a company's affairs through a pattern of racketeering activity, can collect treble damages from the offending party.

ISSUES

1. Does civil RICO require that a person be criminally convicted of a predicate act before being sued for damages?
2. What kind of injuries must a person suffer to sue under RICO? Are injuries stemming from the predicate acts sufficient or must the damages be something in addition to and distinct from the predicate act injuries?

Randolph N. Jonakait is a Professor at New York Law School, 57 Worth Street, New York, NY 10013; telephone (212) 431-2883.

FACTS

Sedima v. Imrex: Sedima, a Belgian corporation, joined with Imrex, based in Great Neck, New York, to furnish missile parts to NATO. The two agreed to divide profits from the joint venture. Sedima negotiated in Europe for the sale of the parts and Imrex obtained them in the United States. As part of the venture's accounting procedures, Imrex was to send Sedima the purchase orders indicating the actual prices for the parts obtained.

Sedima claimed, however, that Gidon Armon, the president of Imrex, and his son Jacob, another officer of the company, sent fake orders that overstated the actual prices. For example, according to Sedima, Imrex bought certain transistors for $4.83 a piece, told Sedima that it had paid $5.25, and pocketed the extra forty-two cents. The profits of the joint venture were based on the inflated, fake costs. Sedima states that it got less money than it should have while Imrex received its share of profits plus the amount by which the Armons overstated the costs of the materials. Sedima sued Imrex under RICO, alleging that Imrex sent the fake orders through the mails, thereby committing the indictable acts of mail fraud.

The federal court for the Eastern District of New York dismissed the complaint. The court of appeals for the Second Circuit affirmed that dismissal on two grounds (741 F.2d 482 (2d Cir. 1984). The court held that before a person can be sued civilly under RICO, he or she must first have been convicted of a predicate act. Neither the Armons or Imrex has been so convicted.

The Second Circuit also held that the complaint was insufficient because Sedima only alleged injury from the commission of the predicate acts. The court stated that to collect under civil RICO, a plaintiff must demonstrate injury "different in kind" from predicate act injury—injury caused "by an activity which RICO was designed to deter." In RICO terms, the court held that Sedima failed to allege the necessary "RICO injury."

American National Bank v. Haroco: Haroco and its related companies borrowed money from Chicago's American National Bank (ANB). The loan agreements pegged the interest charges to the prime rate, defined as

the interest ANB charged its largest and most creditworthy borrowers. Haroco maintains that ANB, acting through Ronald J. Grayheck, an officer and director of ANB, and others, misrepresented that prime rate and thereby collected excessive interest payments. Haroco brought a civil RICO suit claiming that the misrepresentations were fraudulent activities and that the defendants committed a pattern of racketeering activities by using the mails in this scheme.

The District Court for the Northern District of Illinois dismissed the complaint because Haroco failed to allege a RICO injury distinct from the predicate act injuries. The Seventh Circuit reversed this dismissal and held that a plaintiff does not have to allege or prove a separate RICO injury for a valid suit. Damages from the commission of the predicate acts, the court stated, are sufficient for a valid RICO claim.

Thus, the Seventh and Second Circuits are in conflict as to whether a RICO injury must be established for a civil RICO claim. In addition, the Second Circuit has imposed a prior conviction requirement into RICO.

BACKGROUND AND SIGNIFICANCE

In 1970, Congress, to attack the financial base of organized crime and to deter organized crime's infiltration of legitimate businesses, passed RICO—a statute with severe criminal sanctions in addition to the civil remedies at issue in the two argued cases. Congress realized that it could not devise acceptable definitions to outlaw "organized crime;" that term does not even appear in the statute. Instead, Congress adopted the "pattern of racketeering" approach. The result was a broadly worded statute with a potential reach far beyond what is usually thought of as organized crime.

In its first decade, RICO was largely confined to criminal prosecutions. The last few years, however, have seen the filing of hundreds, perhaps thousands, of civil RICO complaints. This explosion has been controversial. The controversy has centered on the use of RICO in commercial disputes concerning allegations of business fraud. Plaintiffs, including states and localities, have found it relatively easy to allege a RICO violation in such situations. The two cases here represent typical complaints. A person claims to be injured from a commercial misrepresentation, then states that two telephone calls or two mailings were made in connection with the misrepresentations and that the person making the calls or signing the letters conducted the affairs of the business. The injured person then contends that such facts entitle him or her to treble damages under RICO.

Critics of such suits state that this is a misuse of the statute. RICO provides extraordinary remedies to attack organized crime, and these claims have nothing to do with organized crime. Instead, they are merely commercial disputes brought against "respectable" businesses. Treble damages in these commercial disputes would be an unnecessary windfall to plaintiffs—actual damages should be the measure of the award. Furthermore, some commentators maintain that these actions are burdening the already burdened federal judiciary since they federalize many disputes that otherwise would be heard in state courts. Finally, the complaints are especially loud about the unfairness of these suits. A jury verdict for plaintiffs would, in effect, label the defendants "racketeers." This label is so repulsive to legitimate, respected business people, it is claimed, that they will settle weak or specious claims just to avoid the bad publicity that would result from being found a "racketeer" or even being tried as one.

The lower federal courts have shown a distinct hostility to RICO suits stemming from commercial disputes, which form the bulk of the civil RICO cases. At stake in these two cases are two court-imposed requirements that could make it all but impossible to bring most civil RICO suits in the future.

The Prior Conviction Requirement: The Supreme Court will effectively kill civil RICO if it adopts the prior conviction requirement. Prosecutions for fraud stemming from commercial disputes are now practically nil, and potential plaintiffs cannot force prosecutors to prosecute. Since prosecutorial priorities are unlikely to change as a result of the decisions in these cases, a prior conviction barrier will almost always be insurmountable.

RICO Injury Requirement: Section 1962 of RICO, according to Imrex and others urging a narrow construction, only forbids certain patterns of racketeering activity. A plaintiff can only collect for injuries that occur "by reason of a violation of section 1962." Thus, a plaintiff must demonstrate harm not from the predicate acts themselves, but from the use of the pattern in the proscribed fashion; in these cases, the use of a racketeering pattern to conduct a business. Since Sedima only alleged injuries that flowed from the predicate acts, it did not state a valid RICO claim.

Sedima and Haroco maintain that the statute contains no express RICO injury requirement; if Congress had intended it, it would have said so. Similarly, those advocating a broad reading of RICO state that a plaintiff only has to demonstrate harm by a defendant's predicate acts in a prohibited fashion to satisfy the statute's requirement of a "pattern of racketeering activity."

Complexity is added to this issue because those who agree that predicate act injury is not sufficient for a RICO claim do not agree on what kind of injury would satisfy the statute. Imrex and a number of *amici* see RICO limited to "racketeering enterprise injury," and argue that RICO was designed to attack organized crime. Therefore, RICO injury is the kind that is characteristic of organized crime or "mobster" activity.

Sedima and Haroco counter that the statute says nothing about conduct characteristic of organized crime, gangsters, or mobsters. Congress knew that to

reach organized crime, it had to pass a broad statute that would reach more than organized crime. Furthermore, the attempts to define conduct characteristic of organized crime are so vague and meaningless that Congress could not have intended such a requirement.

Finally, American National Bank, although it argued for a RICO injury requirement in the Seventh Circuit, shifts its position in the Supreme Court. It contends not that RICO injury must be proved, but instead that a person violates RICO only by committing a pattern of racketeering activity in connection with the management or direction of the enterprise. RICO only prohibits a pattern of racketeering when it is used as an integral part of the business. If the predicate acts are merely incidental to the enterprise's affairs, RICO has not been violated.

ANB's position seems to have the least chance of success before the Supreme Court. Not only was it not argued in the lower courts, it also presents the most unforeseeable consequences since it would affect criminal as well as civil RICO.

The consequences of adopting a "RICO injury" requirement by the Court are more foreseeable. Such a ruling will kill, or at least severely cripple, the present civil RICO. If the Court adopts a competitive injury requirement, civil RICO will, in effect, be gunned down. Few, if any, competitors have sued under RICO, and only in unusual circumstances will competitors be able to establish that they were harmed by a pattern of racketeering activity. Instead, the existing suits are almost all by victims of the predicate acts, who would be barred from RICO suits under a competitive injury requirement.

The Supreme Court could also conclude that a plaintiff must establish injury in addition to and distinct from predicate act injury without defining further what kind of injury will satisfy civil RICO. Such a decision would lead to more litigation as the lower courts are forced to grapple further with a definition of RICO injury.

If the Supreme Court adopts neither the prior conviction nor the RICO injury requirement, the explosion of civil RICO suits will continue. The attempts to limit such claims will not end, however. The main battlefield will then become Congress.

ARGUMENTS

***For Sedima** (Counsel of Record, Franklyn H. Snitow and William H. Pauley, 415 Madison Avenue, New York, NY 10017; telephone (212) 486-9080)*

1. The judicially-forged prohibition against civil RICO claims absent predicate act convictions is an impermissible infringement on legislative authority.
2. A requirement of "mobster"-type injury for a civil RICO claim is an impermissible infringement on legislative authority.

***For Imrex** (Counsel of Record, Alfred Weintraub and Richard Eisenberg, 1010 Franklin Avenue, Garden City, NY 11530; telephone (516) 742-0610)*

1. The clear purpose of the RICO statute, and its treble damages provision, was to attack organized crime and protect the victims of organized crime.
2. Congress intended to authorize damages suits only in circumstances where, in view of the particular kind of injury suffered, it is clear that civil enforcement would be consonant with the overriding goal of fighting "organized crime."
3. The structure of the RICO statute reveals that Congress expected civil suits to be brought only after defendants have been convicted of the underlying predicate acts.

***For American National Bank** (Counsel of Record, Donald E. Egan, 55 E. Monroe Street, Chicago, IL 60603; telephone (312) 346-7400)*

1. Section 1962(c) of RICO is only violated when the pattern of racketeering activity committed by a person is integrally linked with managing and operating an enterprise's affairs.

***For Haroco** (Counsel of Record, Aram A. Hartunian, 55 E. Monroe Street, Chicago, IL 60603; telephone (312) 372-6475)*

1. The district court's requirement of something more than harm resulting from the predicate acts injected unintended words and meanings into RICO.
2. The arguments of both ANB and *amicus* American Bankers Association advocating a racketeering enterprise injury requirement are incorrect and not properly before this Court.

AMICI BRIEFS

Thirty-four states have joined together in a brief in each case; New York State in a separate brief; the cities of Chicago, New York, and Philadelphia have joined together in a brief in each case; Suffolk County, New York; the Interinsurance Exchange of the Automobile Club of Southern California; and John Grado and Technographics, Inc. in a joint brief. (Grado and Technographics are plaintiffs in a pending RICO suit.)

In Support of Imrex and American National Bank

The American Bankers Association; the American Institute of Certified Public Accountants; four property and casualty insurance trade associations with State Farm Insurance in one brief; and the Securities Industries Association. (The Securities Industry, in addition to advocating a RICO injury requirement, argues that at a minimum, no RICO claims should be allowed in areas where narrowly drawn federal statutes pervasively regulate a field, such as securities.)

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