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Five Common Errors in Pleading Civil RICO Claims and How To Avoid Them

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THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT ("RICO"), 18 U.S.C. §§1961-1968, provides great incentives for a successful private litigant. These include treble damages, reimbursement of the cost of suit, and reasonable attorneys' fees (18 U.S.C. §1964(c)), liberal venue and service of process provisions, (18 U.S.C. §1965), and access to both federal and state courts. *Tafflin v. Levitt*, 493 U.S. 455 (1990).

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With these rewards, however, come considerable risks, including Rule 11 and other federal or state sanctions for pleading an unfounded RICO claim, as well as early dismissals on motions to dismiss or their state law equivalent for deficient pleading of a claim.

This article reviews five common errors in pleading civil RICO claims, emphasizing the requirements under 18 U.S.C. §1962(c), the provision under which most civil RICO claims are brought. That section provides that:

"It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt."

The Supreme Court of the United States has interpreted this provision as prohibiting the "(1) conduct [by a person] (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 (1985).

In this article we examine the requirements for pleading:

- A proper enterprise separate from the RICO person;
- A pattern of racketeering activity;
- The required conduct by the RICO person;
- The predicate act of mail fraud; and
- The predicate act of wire fraud.

PLEADING THE SEPARATE "PERSON" AND "ENTERPRISE" REQUIREMENT • Virtually every court which has interpreted section 1962(c) has agreed on one point: That separate and distinct entities must serve as the "person" and "enterprise" under that section, and that only the person operating the enterprise can be held liable for damages. *See*, *e.g.*, *Board of County Commissioners v. Liberty Group*, 965 F.2d 879, 885 (10th Cir.), *cert. denied*, 506 U.S. 918 (1992); *Bennett v. U.S. Trust Co.*, 770 F.2d 308 (2d Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986). This requirement of separate and distinct persons and enterprises applies under section 1962(c), but *not* under sections 1962(a) and (b). *See*, *e.g.*, *Busby v. Crown Supply, Inc.*, 896 F.2d 833, 840-842 (4th Cir. 1990) (*en banc*).

Two of the common problems which occur in pleading separate persons and enterprises are posed when plaintiffs attempt to use an existing parent-subsidiary relationship, or attempt to plead an "association-in-fact."

Stautory Model: Infiltration of Legitimate Enterprise by Racketeer

To understand the proper use of such entities in pleading a section 1962(c) claim, it is helpful to recall the original legislative purpose for RICO, which was designed to stop the infiltration of legitimate businesses by organized crime. The original structure of the statute, which some courts have now suggested no longer limits civil RICO claims, contemplated an infiltrating racketeer and an innocent entity. The infiltrating racketeer became the RICO "person," while the innocent entity taken over by the racketeer became the RICO "enterprise." The underlying concept was that the infiltrating racketeer caused the entity to engage in the unlawful activity, and that the entity was a victim of the racketeer.

Parent-Subsidiary: Must Plead Parent Caused Subsidiary To Act

Based upon this statutory structure, a parent and subsidiary can form separate RICO persons and enterprises in appropriate circumstances. The most common pleading problem in utilizing this relationship to satisfy the separate person and enterprise requirement occurs where a civil RICO plaintiff depends upon a *passive* par-

ent-subsidiary relationship, contending that the subsidiary, in its normal activities, acts on behalf and to the benefit of the parent. Some early cases suggested that this was sufficient. *See, e.g., Haroco, Inc. v. American National Bank & Trust Co.*, 747 F.2d 384, 402-403 (7th Cir. 1984), *aff'd on other grounds*, 473 U.S. 606 (1985). The clear trend in the current cases is to require an active *interaction between parent and subsidiary*, along the lines of the statutory structure. As one court has properly noted, a civil RICO plaintiff seeking to advance a claim under section 1962(c) must "plead facts which ... would clearly show that the parent corporation played a role in the racketeering activity which is distinct from the activities of its subsidiary. A RICO claim under section 1962(c) is not stated where the subsidiary merely acts on behalf of, or to the benefit of, its parent." *Lorenz v. CSX Corp.*, 1 F.3d 1406, 1412 (3d Cir. 1993). Thus, to properly plead a separate person and enterprise under section 1962(c), a civil RICO plaintiff must plead facts indicating that the parent corporation, as the RICO "person," caused its subsidiary to take certain actions to carry out the unlawful directions of the parent. Such pleading establishes a proper claim under section 1962(c).

Association-in-Fact Cannot Be Used To Evade Separate Person and Enterprise Requirement

Proper use of an association-in-fact enterprise presents related but more complex problems. To begin with, the statutory definition of a RICO "enterprise" "includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact, although not a legal entity." 18 U.S.C. §1961(4). Although the statute refers to "individuals associated in fact," the courts have interpreted this to include corporations as well. *See, e.g., Shearin v. E.F. Hutton Group, Inc.*, 885 F.2d 1162, 1165-1166 (3d Cir. 1989). To preclude the use of an association-in-fact enterprise as a pleading vehicle for evading the separate person and enterprise requirement, courts have evolved different, and sometimes inconsistent, tests for pleading an appropriate association-in-fact enterprise. As such, a civil RICO plaintiff must carefully research the applicable law in the appropriate federal circuit or state court where suit is to be brought.

Elements To Plead

Generally, however, courts require that an association-in-fact must be an ongoing entity which:

- Functions as a continuing unit;
- Has some type of organization, formal or informal;
- Has a common or shared purpose; and
- Constitutes an entity separate and apart from the pattern of racketeering activity in which it is alleged to have engaged.

See, Model Jury Instructions for Business Torts Litigation §5.07[2] (ABA 3d ed. 1996).

Errors To Avoid

There are several common pleading errors involving proposed association-in-fact enterprises.

First, where multiple entities are involved, it is important, as it was in the parent-subsidiary case, to plead an active interaction among the various entities, and to identify the defendant person directing or influencing the unlawful activities of the other members of the alleged association-in-fact. *Compare, Atlas Pile Driving Co. v. DiCon Financial Co.*, 886 F.2d 986, 995-996 (8th Cir. 1989) (proper association-in-fact) with *Vandenbroeck v. Commonpoint Mortgage Co.*, 22 F.Supp.2d 677, 682 (W.D. Mich. 1998) (improper association-in-fact since "there is no allegation that [defendant person] directed or influenced decisions made by its end lenders and investors or vice versa, nor do Plaintiffs allege that any