

RICO REPORT

RICO Conduct Element

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[CAL STEIN]

Hello and thank you for joining me on this installment of the RICO Report where we're going to talk about the RICO Conduct Element. My name is Cal Stein, and I am a partner in the White Collar and Litigation Practice Groups at Troutman Pepper. I represent client's with white collar criminal and government investigation matters, as well as complex, civil lawsuits, and RICO Litigation. I am very pleased to have my partner, Joanna Cline, here with me today to talk about the four subsections of RICO conduct that are found in 18 U.S.C. §1962. Joanna is a Commercial Litigation Partner out of Troutman Pepper's Wilmington office. Joanna, it's wonderful to have you here today. Why don't you tell us a little bit more about yourself.

[JOANNA CLINE]

Thanks, Cal. Great to be here. I am the Office Managing Partner of our Delaware office. I focus on complex commercial litigation on the civil side. I'm not a criminal lawyer. But, we do a fair amount of Civil RICO securities, corporate governance, and basically, anything that happens in the Delaware Court of Chancery.

[CAL STEIN]

Terrific. Well, we really appreciate you being here today to talk about the RICO Conduct Element, and let's jump right into that. So, the RICO Statute contains a subsection amply titled, "Prohibited Activities", and, as I said, that's found at 18 U.S.C. §1962. That Section actually contains four subsections labeled, "Sub A through Sub D" that enumerate the specific conduct that the RICO Statute prohibits. And, today, for the purposes of this podcast, we're gonna actually follow the RICO Statutes organization, and we're gonna discuss in detail, each of these four types of conduct, individually. For context though, the four types of prohibited conduct are investing the proceeds from a pattern of racketeering activity in an enterprise, acquire or maintaining an interest in an enterprise through a pattern of racketeering activity, conducting the affairs of an enterprise through a pattern of racketeering activity, and then the final section is conspiring to do any of those things. And, before we get into our discussion of each of those four subsections of the RICO Conduct, I want to take a moment to address briefly, some of the other RICO concepts that we're gonna be discussing today. But, which are not going to be the focus of this episode, but they may be the focus of later ones. But, not today. Specifically, I want to talk about the RICO person, versus the RICO enterprise. Joanna, you have some experience with these concepts. Can you briefly take us through them so listeners can follow along with our discussion today?

[JOANNA CLINE]

I mean, as you sort of hinted at, the Person Enterprise Distinction could be the subject of a whole other podcast onto itself. So, today, we're just looking at the big picture, really. Which is that RICO defines person broadly. So, that can be any individual or entity capable of

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holding an interest in property. And, then when you look at enterprise, RICO likewise defines that enterprise broadly. And we might think, sort of an everyday parties of the quintessential RICO Enterprise as an illegitimate enterprise, like the Mafia. But, it can just as easily be a legitimate enterprise. And it gets tricky, as it can be an individual or an entity, or a group of associated individuals or entities. And, trying to distinguish once you get through the weeds of all of this between the person and the enterprise can get confusing. It's not our mission today to try to figure that all out. But, the concept is important to our discussion today because under three of the four subsections we're discussing, A, B and D, the RICO person and the enterprise can be the same thing, but importantly under Subsection C, which I think we'll find is where the action is, those two concepts have to be distinct.

[CAL STEIN]

So you're quite right, Joanna. This could be the subject of its own stand-long podcast, and may one day be the subject of such a podcast. But, for today, that's a helpful distinction to understand and I appreciate the summary. So, with that, let's turn to the first subsection, which is Section 1962(a), which involves the investment of racketeering proceeds. And, generally, the conduct that is prohibited by this section is something of an anomaly in the RICO world because the essence of a violation under 1962(a) is not the commission of the actual racketeering acts, but rather it's the investments of the income derived from those racketeering acts. The elements of a 1962 violation are number one, a person derived income from racketeering activity, number two, that person then used or invested that income, number three to acquire, establish or operate a RICO Enterprise. And when we were preparing for this podcast, Joanna, we were talking about just how atypical Section 1962(a) RICO Claims are. And, I just spoke about how this subsection is a bit unique because the critical conduct is not the racketeering activity, but rather what the perpetrator of those racketeering acts does with the proceeds. Do you think that kind of unique set up is one of the reasons that we as Litigators don't really come across 1962(a) Claims all that frequently?

[JOANNA CLINE]

I think that's right, Cal. One of the big challenges of a 1962(a) Claim and one of the reasons they're rare, is that a plaintiff must trace injuries to the investment of the proceeds, as you say. So, for example, in the context of the sale of a stock in a business, if a party purchases with income that derived from racketeering activity, like wire fraud, or securities fraud, that would be the requisite investment for 1962(a) purposes. What we're really talking about here is money laundering and it's not all that common.

[CAL STEIN]

I think that's exactly right. Another paradigm we sometimes see for 1962(a) purposes is when a party makes an investment with a loan that he or she obtained through racketeering acts. Usually, wire fraud, but it could be a couple of other things. But, notwithstanding these examples, even pleading, much less actually proving a 1962(a) Claim, and that one has actually been injured by virtue of the investment of ill-gotten proceeds can be very difficult, which is one of the reasons as you noted, we don't see them all that often. Okay, so as we move through the various subsections here, and we will get to some that we see more frequently, and therefore, there's a little bit more law and many legal issues for us to talk about. Let's move to the next subsection which is 1962(b), which is Acquiring or Maintaining an Interest in an Enterprise. And, the conduct that's prohibited by 1962(b) is actually

somewhat similar to the conduct that's prohibited by 1962(a). The major difference being that 1962(b) prohibits the acquisition or control of an enterprise through racketeering acts, rather than through the investment of income derived from the racketeering acts, like we saw in 1962(a). There are two elements for a 1962(b) Claim. The first is that a person committed racketeering acts, and the second is that the person did so for the purpose of acquiring or maintaining an interest in or control over a RICO Enterprise. And when analyzing a 1962(b) Claim, the key for me is that there has to be a connection or a nexus between the racketeering activity, and the acquisition of the interest in or the control over the enterprise. I note that the critical component is not the racketeering activity itself, it's the acquisition of control. The injuries under a 1962(b) Claim must also stem from the acquisition of control. It is not sufficient that they come from the racketeering acts themselves. That's a nuance in a distinction that's actually quite important. And some courts have even held that the damages have to be different. The damages that arise from the acquisition of control have to be different than the damages arising from the racketeering act themselves. That's what I find interesting about these claims. But, how about you, Joanna? What do you find most interesting or challenging about 1962(b) Claims?

[JOANNA CLINE]

Yeah, and again, these are few and far between, so it's not like these get a lot of air time. But, we can look at the other piece of the equation you mentioned for subsection (b) Claims, which is what constitutes an interest or control over an enterprise. In essence, to satisfy that requirement, the person must have played some significant role in the management of the enterprise, though establishing that he or she had complete control is not necessary. So, as you can see just by the articulation of that standard, it's a highly specific fact of determination, which can be quite frustrating for the RICO Defense Bar because it makes for hard argument to assert at the Motion to Dismiss stage. So it gets to be expensive.

[CAL STEIN]

Yeah, unfortunately, I think you and I have both had that experience in various RICO Claims. Okay, well as you said Subsection B like Subsection A, they're out there, but there aren't that many claims that are brought under those subsections. The vast majority, which you alluded to, Joanna, are brought under the next section, which is 1962(c), which is Conducting the Affairs of an Enterprise through Racketeering Activity. As noted, 1962(c) is by a wide margin the most commonly used RICO subsection, and that applies to both criminal prosecutions and civil actions. On its face, you might think that subsection C appears to be less demanding than some of the other RICO sections. And, while the language may convey that, the Courts have not always interpreted it as broadly as the others perhaps as a function of the frequency with which it is used in comparison to the others. The elements of a 1962(c) Claim are as follows: first, a person who is employed by or associated with the RICO Enterprise, second, conducts or participates in the conduct of that enterprise's affairs through, three, a pattern of racketeering activity. And, again, because of the frequency with which these types of claims are brought under this subsection is actually quite a bit of case law out there interpreting these elements. So, let's take a moment and really unpack some of this in a way that we weren't able to with the other two. Joanna, earlier in the podcast you talked about the RICO person, versus the RICO Enterprise distinction, and you noted that those rules were a little bit different for 1962 Claims. Can you elaborate on that a little bit?

[JOANNA CLINE]

Yeah, sure. And, then again, in a lot of ink has been spilled on this person enterprise distinction. So we're just going to hit it at a high level. But, generally speaking, it goes back to the text of the Statute, because under Subsection C, the person must be employed by or associated with the Enterprise. Reports say that those two things must be distinct. That means that a defendant to a 1962(c) Claim cannot be both a person and the enterprise. Now, courts do recognize that a person may be a member of the enterprise, but it can't be the same thing. So, when that sort of gets confusing, and when it often comes up that we see a lot in the context of whether a corporation is distinct from the individuals who operate the corporation. So, for example, there was a famous Supreme Court case called, "*Cedric Kushner Productions Promotions v. King*" and by King mean Don King, where the Supreme Court held that even where a corporation has a single stockholder, the corporation itself and the stockholder are distinct for RICO purposes and the individual human can face liability in terms of being a person under the statute. But, compare that against some other cases when a plaintiff seeks to hold the corporation liable as a person in those circumstances, courts have rejected the liability there because in that case, seeking to hold the corporation liable would essentially be saying the corporation is operating itself, and that's not sufficient. So, again, it's very nuance, but the big picture takeaway is you have to pay attention to whether the person and the enterprise are distinct, and it gets super tricky in the context of corporations and their directors.

[CAL STEIN]

I'd have to say, I love that Don King case. We're all familiar with it, but I do love it. Another off litigated question under Subsection C of 1962 is what exactly constitutes conducting or participating in an enterprises affairs? The U.S. Supreme Court has actually weighed in on this, and imposed a managerial gloss from this requirement, basically, saying that only those who have the ability to direct the operations or management of the enterprise can satisfy the settlement. And, the case here is another famous one. *Reves v. Ernst & Young* reads the Ernst and Young, and here's what the Supreme Court said in that case. In order to participate directly or indirectly in the conduct of such enterprises affairs, one must have some part in directing those affairs. What is really interesting to me about this case is, I think the Supreme Court thought the it was announcing a rule that would be kind of easy for the lower court's to apply, but as is often the case, this managerial test has been anything but easy. At least in my experience. How's it been for you, Joanna?

[JOANNA CLINE]

We have a colleague in our Philadelphia office, and every time I mention to him that I'm doing a podcast or giving a CLE, he always says, "Let me know what the question is." And, then he interrupts me and he says, "I know it doesn't matter what the question is because the answer is it depends." And, he's not entirely wrong, I have to say. So, with this question of the managerial test, one reason that it's not susceptible to a simple insider versus outsider distinction, is because it's the case law is not such that all individuals inside the enterprise, which formal positions necessarily satisfy it, while all those outside do not. So let's break that down a bit. So let's look at insiders. While the majority of individuals who do conduct the affairs of an enterprise qualify as insiders, but being an insider is not in and of itself sufficient. That's not enough to get you there. Courts have been pretty clear. That merely performing services for an enterprise does not equate to conducting its affairs even if the person

performs services with knowledge of solicit activity. In other words, even for insiders, there's no per se test. Not even for people whose title places them in upper management. To satisfy the requirement, a plaintiff must still establish the person's managerial role within the enterprise. So that's insiders. And now, let's take a look at outsiders. The same is true, really. Although fewer outsiders are going to satisfy the managerial test for obvious reasons. But, there's no per se rule that applies, and the Supreme Court made this clear in the *Reves* case. It held that status as an outsider is not dispositive. While complete outsiders, which is defined as those who manage their own affairs, as opposed to the affairs of the enterprise do not qualify. Other outsiders who do manage the affairs of the enterprise will qualify. And that as the law has developed, the rule on outsiders is essentially become that those who go beyond the routine rendition of professional services and become so intertwined with the enterprise, may be said to conduct its affairs for 1962(c) purposes. Again, we're talking again about a fact intensive inquiry that drives the defense bar crazy.

[CAL STEIN]

This one does drive me crazy because there's so many times you want to argue it on Motion to Dismiss, but you can't quite get there because the facts aren't developed enough yet. So, as we said, that's Section 1962(c) in a nutshell. That's the most common RICO Subsection where claims are brought. But, we'd be remised if we didn't address the fourth section as well, which as a White Collar Criminal Defense Attorney, the bit near and dear to my heart, which is 1962(d) The Conspiracy to Commit a RICO Violation Subsection. 1962(d) is something of an outlier for the other RICO subsections, and it's also an outlier from what we often think of as traditional conspiracy law. And the reason for this, is that the crux of a 1962(d) RICO Conspiracy Claim is the agreement, the agreement amongst the co-conspirators to commit the conduct that violates one of the three subsections that we just talked about. And, 1962 (d) is really concerned only with that agreement, not whether the violation was actually completed. There are three elements to a 1962(d) Claim. The first is that two or more people agree. Number two is they agreed to invest in, that's 1962(a) Claim, acquire that's a 1962(b) Claim, or conduct the affairs of, that's a 1962(c) Claim, a RICO Enterprises, and then third, in a manner that violates one of those three subsections that I just mentioned. And, you know, I always struggle with this one, Joanna, because as I just mentioned, you know, I am a White Collar Criminal Lawyer and when I hear conspiracy, I think about all the rules that apply in the criminal context. But, a RICO conspiracy is really quite different.

[JOANNA CLINE]

Yeah, agreed. So, and even in the civil context when you think of RICO. Sorry, when you think of conspiracy, you think of the agreement and an act in furtherance of the agreement. That is not the same ballgame when you're in the RICO context. The RICO Conspiracy is complete upon the agreement. And, so the test for establishing an agreement requires a two part showing. Number one, that the defendant agreed to facilitate the operation of a enterprise through a pattern of racketeering activity. And, number two, that the defendant agreed that someone, though interestingly not necessarily the defendant him or herself, would commit a least two predicate acts. So with respect to that second prong, that means there is no requirement in Subsection D Claims that the defendant himself commit the pattern of racketeering activity. Under 1962(d), it is enough that a person agreed with another person, and intended to further and endeavor that would, if it were completed, satisfy the elements of one or the other RICO sections.

[CAL STEIN]

Yeah, it's such a departure from what we typically think about in terms of conspiracy claims that I always find it really, really interesting. The other piece of a 1962(d) RICO Conspiracy Claim that I find interesting is how it interacts with other claims that are brought under the other RICO Subsections that we've discussed, which they often are. Have you found that, Joanna?

[JOANNA CLINE]

Yeah, so they often are and the question then becomes, "Do they have to be?" So, the question then becomes whether a viable claim for A, B, or C is necessary for someone to pursue a claim under Subsection D. And, the courts are divided on the issue. Some say that a plaintiff can bring a conspiracy claim even if other claims under A, B, and C are dismissed, so long as they can prove the elements of 1962(d) standing alone. Others have held that a Subsection D Claim cannot stand on its own. And some have even dismissed the Subsection D Conspiracy Claim because the plaintiff failed to properly cleave the underlying A, B, or C Claim. So it's important to know what the particular jurisdiction you're dealing with says on the issue.

[CAL STEIN]

Yeah, that's a situation that as defense attorneys I think we've all been in where we're writing our Motion to Dismiss or our Summary Judgment Brief and we're saying, "Well, the conspiracy claim fails for all the same reasons we just wrote because the underlying claims fail as well." Maybe not case for a RICO Conspiracy Claim depending on the jurisdiction that you're in. Well, Joanna, we're about out of time here today. So, I do want to bring this discussion to a conclusion. I really want to thank you for joining me on this podcast. I also want to thank everyone for listening. I hope that you will all join us for our next regularly scheduled installment in which we'll be discussing the RICO Enterprise, which we talked a little bit about today. If you have any thoughts or any comments about the series, I invite you to contact me directly at callan.stein@troutman.com. If you have any thoughts or comments about this episode, you can also contact Joanna, directly at joanna.cline. That's c-l-i-n-e@Troutman.com. You can subscribe and listen to other Troutman Pepper podcasts wherever you listen to podcasts, including on Apple, Google, and Spotify. Thank you for listening, and stay safe.