## RICO REPORT

## UNDERSTANDING THE RICO ENTERPRISE REQUIREMENT

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Cal Stein: Hello, and thank you for joining me on this installment of the RICO Report, where we are going to talk about the RICO Enterprise. My name is Cal Stein and I'm a partner in the white collar and litigation practice groups at Troutman Pepper. I represent clients in white collar criminal and government investigation matters, as well as in complex civil lawsuits and RICO litigation. I am very pleased to have my colleague Sam Harrison here with me today to talk about what makes a RICO enterprise, and how it applies to RICO conduct, particularly that of section 1962(C), operating a RICO enterprise. Sam, it's wonderful to have you here today. Why don't you tell us a little more about yourself?

Sam Harrison: Yeah, it's great to be here. Thank you so much, Cal. I'm a business litigation associate in Troutman and Pepper's Philadelphia office, and in that capacity I advise clients in complex civil disputes, and those disputes often involve RICO claims, and often in a class action context. My experience with RICO dates back four or five years at this point. I've been working on a very complicated class action alleging RICO claims throughout the country. So happy to be here, happy to talk about the enterprise requirement, which is near and dear to my heart.

Cal Stein: As it is to mine. Well thank you again for being here. As I mentioned, we are going to be talking about this very important piece of RICO law, that of the RICO enterprise, and as Sam alluded, the RICO enterprise is really at the heart of any RICO case. And as we will see, it's one of the things that really separates RICO cases from other civil litigation. But to understand the RICO enterprise is to understand the RICO statute generally. So before we get into the details of what is and what is not a RICO enterprise, I want to take a step back and place the concept of the RICO enterprise within the statute at large. And as we know, Congress initially passed the RICO statute to combat organized crime. Thinking about that overall goal is important when trying to understand the RICO enterprise requirement and how it fits into the statute overall.

So what did Congress really mean when it set out to combat organized crime? Well, from the RICO statutory language, we see what Congress was really concerned about was preventing and punishing the infiltration of legitimate businesses by the organized crime element. And that is what spawned the RICO enterprise element. And let's ground this concept in the statute itself for even greater context. As we know, from a previous episode, the conduct the RICO statute prohibits is found in section 1962. It prohibits four categories of conduct in subsections A through D. All of that conduct involves an enterprise. Section A prohibits the investment of funds derived from racketeering activity in an enterprise. Section B prohibits the acquisition of control of any enterprise using

those funds. Section C prohibits conducting an enterprise through racketeering activity. And section D, of course, is the conspiracy provision.

So put another way, the RICO statute does not really target the enterprise itself. It targets those, whether they be individuals or entities, that misuse an enterprise or who wrongfully acquire an enterprise, and this is important to remember. And it is for this reason that a RICO enterprise need not be an illegitimate operation. Many people just assume that an enterprise is a bad thing. Not so. Sometimes it is, but an enterprise can be legitimate as well. Now there is one more requirement of a RICO enterprise that I want to mention briefly now before we get into the meat of our discussion, because while it's important, it's not really one that requires much discussion at all. And that is the requirement that the enterprise affect interstate commerce. This doesn't require much discussion because courts have found that it is fairly easily satisfied.

To affect interstate commerce the enterprise need only engage in interstate commerce or engage in some activity that impacts interstate commerce. And this can be almost anything in the right circumstances. Ordering supplies, transporting employees, communicating across state lines, using emails or telephones, or even snail mail, all have been found to qualify. So in this day and age enterprises will likely satisfy this requirement. Okay, so with that introduction and context, and now that we understand how the enterprise requirement fits into the overall RICO statute, I want to dive in and start discussing what an enterprise is and how a RICO plaintiff must prove it. And let's start, as we always do, with the text of the RICO statute itself. RICO section 1961-4 defines an enterprise as an individual partnership, corporation, association, or other legal entity and any union or group of individuals associated in fact, although not a legal entity.

The language is broad and court interpretations of the language have been even broader. The most common type of RICO enterprise is the association-in-fact enterprise, as it's been called. Any group of entities or individuals can be an association-in-fact enterprise, and a lot of paper and oral argument has been devoted to this broad interpretation of the RICO requirement. And while the current legal landscape has developed some clearer rules as to what constitutes an association-In-fact enterprise, the legal history of how we got here is complex and at times inconsistent, but understanding that history is, again, helpful context. Historically many US courts required an association-in-fact enterprise to have some formal structure or organized hierarchy. For example, in 1982, the Eighth Circuit decided a case, *US v Bledso*, that found an association-in-fact enterprise must have three characteristics. One, common or shared purpose among its members. Two, some level of continuity of its structure and its personnel. And three, a structure that was distinct from the pattern of racketeering.

Several other circuits reached similar conclusions, notably the Fifth, Sixth, and Seventh, and these decisions were generally derived from a Supreme Court decision the year earlier called *US v Turkette* that held the RICO enterprise cannot be established just through evidence of racketeering acts. But not all courts agreed, and that resulted in the dreaded circuit split. The First, Second, Ninth, Eleventh, and DC circuits held that an association-in-fact enterprise did not require any particular organization or structural elements. The Ninth Circuit took it a step further, holding that an association-in-fact enterprise did not need anything separate and apart from what was needed to commit the racketeering activity.

Sam Harrison: And Cal, I think that brings us to the 2009 decision by the Supreme Court in Boyle versus United States, which resolved this circuit split among the First, Second, Ninth, and Eleventh circuits on one hand, and the Fifth, Sixth, and Seventh on the other hand. In Boyle, the Supreme Court Decided that an association-in-fact enterprise needs to have some structural elements to it, and it created three specific inquiries that were designed to assess that. The first is a purpose among the constituents of the enterprise. The second is relationships among those who are associated with the enterprise. And the third is a somewhat vague instruction that there needs to be longevity sufficient to permit those associated to pursue the enterprise's purpose. The Supreme Court explicitly rejected the notion that an association-in-fact enterprise needed any sort of formal hierarchy.

So thinking back to what you noticed that RICO was originally focused on organized crime, you don't need some mafia-esque hierarchy or chain of command. That might be a feature of a RICO enterprise, but it's not a requirement of a RICO enterprise. There don't need to be dues paid or rules followed or policies, but there does need to be a purpose among the constituents of the enterprise. And how the Supreme Court discussed the purpose element is what was most meaningful. In Boyle, the Supreme Court stressed that even though, as Cal, you noted in Turkette, the existence of a pattern of racketeering activity doesn't automatically satisfy the requirement that the enterprise have a purpose. Sometimes that is enough. Sometimes the fact of the predicate acts that are involved shows that the constituents of the association-in-fact enterprise did have a common purpose among them. But the Supreme Court was clear. It's not eliminating the distinction requirement. The same evidence may be used to prove two separate elements of RICO, but it doesn't mean that the two elements collapse into one. So you still need a purpose and you still need predicate acts.

Cal Stein: That's exactly right, Sam. So having resolved the circuit split after many decades of it existing, Boyle remains the standard that is applied today. But now that we know that standard, let's talk about what needs to be proven to satisfy it, or how a defendant can defend against it. One thing is that the entities and the

individuals of the enterprise needed to have worked together in some coordinated way. And let's use Boyle to actually illustrate this point. Sam, as you just discussed, you obviously know this case and you follow the other cases that have cited to it. Can you walk us through some of what you have seen starting with that Boyle case?

Sam Harrison: Yeah, so Boyle's an interesting case and it has sort of fascinating facts to it, but it's about a group of individuals who worked together in the 1990s to commit a lot of bank robberies and bank thefts. The individuals were focused on a core group, so there were several folks who were involved in most of the bank thefts, but then there were folks who floated in and out and were there for a few of the bank robberies and thefts and not there for others. The participants would meet before the thefts, would plan them out, would gather supplies together that they would need, and would assign rules, like who's the getaway driver, who's the one who's going to be cracking the vault, that sort of thing.

At the conclusion of the trial, the district court rejected the defendant's invitation to instruct the jury that the government needed to show that there was an ascertainable hierarchy within the association-in-fact enterprise, but the trial court rejected that invitation and it instructed the jury instead that an association of individuals without a structural hierarchy could nevertheless form an association-in-fact enterprise. On appeal, ultimately, to the Supreme Court, the court held seven to two through Justice Alito that an association-in-fact enterprise does require a showing of structure, but importantly, it doesn't require a rigid hierarchy to form that structure. Structure simply means the way in which the parts are arranged or put together to form a whole. There's no chain of command requirement. The court remarked, instead that we see no basis in the language of RICO for structural requirements like a chain of command or, or a strict hierarchy. And turning back to Turkette, an association-in-fact enterprise is simply a continuing unit that functions with a common purpose. That's the extent of the structure that you need.

And I think what's most revealing about Boyle and the facts of Boyle as it relates to this notion of a structural hierarchy is how the majority's opinion contrasts with Justice Stevens' dissent. Justice Stevens remarked that his understanding of RICO and how he saw it to be applied was that it was meant to be applied to businesslike entities. Entities that have a CEO and have vice presidents under them, or have the equivalent. And the majority certainly recognize that that can absolutely be a RICO association-in-fact enterprise, and there are legion examples in the case law of RICO association-in-fact enterprise that do have a strict hierarchy to them. But to impose that as a requirement was just not supported by the text of RICO. So after Boyle, we end up with it being quite clear that you don't need the same cast to be involved in every predicate act, and you don't need anybody to be calling the shots in particular to establish an Enterprise.

Cal Stein: Yeah, so one of the things I have always found interesting about this analysis of an enterprise's structure is the extent to which the members of the enterprise have to have coordinated. Now we see this pretty clearly in the facts of the Boyle case, but it's not as clear in other cases, and it has become settled law that it's really not necessary for every member of the enterprise to have participated in every one of its activities. Generally participating and generally knowing that the enterprise extends beyond any one individual's role has typically been found to be sufficient by many courts. But I don't want to stray too far from what you were just talking about, Sam. What else have you seen?

Sam Harrison: Another thing that I find fascinating, and you alluded to it earlier in the context of the commerce clause, an association-in-fact enterprise doesn't need to have an economic motive or purpose to it. Certainly if you look at the list of predicate acts in the RICO statute, many of them inherently have a financial component to them, fraud, things of that nature, but it's not a requirement. And the Supreme Court actually addressed this specific issue in National Organization for Women versus Scheidler. In that case, the Seventh Circuit affirmed the dismissal of a RICO claim against an anti-abortion activist group, and the allegations brought by the plaintiff were that the group engaged in acts of extortion to force abortion clinics to close.

The Seventh Circuit dismissed the case, saying this doesn't look like an ordinary RICO enterprise. There's not a profit seeking venture here. This is advocacy work. The Supreme Court didn't buy it and reversed. It held that a RICO enterprise doesn't need to have an economic motive. It's rationale was simple for that. Nowhere in the statute does it say you need a profit seeking venture to be an enterprise. To quote the Supreme Court's analysis, putting it succinctly, an enterprise surely can have a detrimental influence on foreign commerce without having its own profit seeking motives, and that's exactly what happened in National Organization for Women.

Cal Stein: So I want to pivot now to the application of the enterprise element to one of the specific sections of RICO, and I alluded to it earlier. It's the 1962(C) conduct section, which as we have discussed on this podcast, is by far the most commonly used RICO section. And by way of reminder, 1962(C) prohibits the conducting of a RICO enterprise through a pattern of racketeering activity. So let's talk now about how the RICO enterprise operates within the context of 1962(C), and in doing so we see some of the specific issues that can and do often come up. And again, I want to start, as we do, with the statutory text. The specific language of 1962(C) makes it illegal for any person who is employed by or associated with any enterprise to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity.

Based on this language, every court of appeals has concluded that a party cannot be both the RICO defendant and the RICO enterprise. They can, of course, be a defendant and a member of a larger association-in-fact enterprise, but the defendant cannot be one and the same as the enterprise. And I think the best way to understand this is to use an example. So let's consider the following. Suppose there are three individuals, let's call them Moe, Larry, and Curly. Moe has a problem with a fourth individual, let's call him Shemp. So Moe recruits Larry and Curly to defraud Shemp out of all his money. They work together, they plan the fraud very carefully, and acting in concert, but at the direction of Moe, they defraud Shemp out of half a million dollars over the course of several years. If Shemp wanted to bring a civil RICO suit against Moe, he probably could. Moe would be the defendant, and Moe, Larry, and Curly working together would be the RICO enterprise.

But what if instead of recruiting Larry and Curly, Moe acted alone? If he, acting all by himself, defrauded Shemp out of that same half a million dollars over that same time period doing all the same things, could Shemp bring a RICO claim? No. The defendant would be Moe and the enterprise would be also Moe. Shemp could bring a claim for conversion or fraud, but not for civil RICO. Why not? Well, Moe directed the operations of himself, but not of an enterprise, thus, he would not meet the requirements of 1962(C). And I note this distinction is premised on the exact language of 1962 that I just recited, so most courts have held that it does not apply to the other RICO conduct sections, or at least to sections A and B. We know that a person cannot be the RICO enterprise himself or herself, but they can be part of a RICO enterprise. That makes some sense in the context of an individual. But Sam, what about this rule in the context of a corporation?

Sam Harrison: Yeah, so there's actually a Supreme Court case that deals directly with this issue, and it's a case that most RICO practitioners are pretty familiar with, not only because it comes up more often than you'd think, but also because it's a pretty memorable case involving pretty memorable characters. The case involves Don King, the boxing promoter, and the case is called Cedric Kushner Promotions versus King. And in it, the Supreme Court addressed a really focused question, which is what if you have an individual who's carrying out the conduct of an enterprise, and the enterprise is a corporation that is wholly owned by the person carrying out the conduct of the enterprise?

To give you the facts specifically, the plaintiff in Cedric Kushner was a rival boxing promoter, and he alleged that Don king operated his business, of which he was the sole shareholder, as a RICO enterprise. The appellate court, thinking it was doing the right thing, applied the distinctiveness requirements, said that Don King was not distinct from his promotion company. Much like the example he gave above, Moe wasn't distinct from Moe and wasn't an enterprise. But a unanimous Supreme Court reversed, explaining that when a corporate

employee unlawfully conducts the affairs of a corporation, even where the corporate employee is the sole owner of the corporation, that nevertheless forms an enterprise. Essentially the sole owner is using the corporation as a vehicle to commit predicate acts, and the individual owner and the corporation thus meet the enterprise requirement.

So while RICO requires two distinct entities, a person on the one hand and an enterprise on the other hand, the person, if he owns the corporation can essentially create an enterprise on his own. And I think the Supreme Court summed it up really well. It says the corporate owner employee, a natural person is distinct from the corporation itself, a legally different entity with different rights and responsibilities due to its different legal status. The court couldn't find anything in the RICO statute that required more separateness than that. So turning to your hypothetical above, if Moe forms his own LLC and does the same things, and he's the only member, then he's right back into a RICO cause of action.

Cal Stein: Right, so that explains the rule and the context of a sole shareholder and his or her corporation. But now I want to talk about a slightly different, but related context. What if the government or a RICO plaintiff alleges that a corporation is a RICO defendant, and the association-in-fact enterprise is all of the people that make up the corporation, i.e. the owners, the directors, the board, all of those folks? Does that satisfy this person enterprise distinction. And this is a real scenario because often it is the corporation itself that has the money to pay RICO's trouble damages, so we do see RICO plaintiffs trying to bring RICO cases in exactly this scenario. And we know from earlier, and from what Sam said, that an individual can be held liable under RICO for operating the affairs of a corporation.

The opposite, however, is not always true. A corporation generally cannot be held liable as a RICO defendant for operating an association-in-fact enterprise that consists of itself and the people who comprise it. Courts often find in these circumstances that the corporation is operating itself. Thus there is no distinction between the defendant and the enterprise. And the Second Circuit explained this rationale. It said because a corporation can only function through its employees and agents, any act of the corporation can be viewed as an act of such enterprise. And as some courts have acknowledged in this context, a crucial factor in determining whether an association-in-fact enterprise exists is whether each member of the enterprise has the freedom to act for himself or herself and advance his or her own independent interest separate and apart from the enterprise.

Think about the Boyle case. The individuals work together to target and execute robberies, but each could have chosen to act independently or prioritize his own interests. So as we noted above, a 1962(C) RICO case requires proof that the

defendant conducted or participated in conducting the affairs of an enterprise through a pattern of racketeering activity. So now I want to talk about the enterprise element as it relates to that. And this is another area, the conducting the affairs of a RICO enterprise, where the Supreme Court has weighed in and provided some helpful guidance. Sam, why don't you tell us about what the Supreme Court has said?

Sam Harrison: Thanks, Cal. And as you know, one question that often comes up is you have a RICO enterprise, who can be liable for its predicate acts? Who can the actual defendants be? Thinking back to Boyle, obviously the individuals who broke into the banks were liable for the predicate acts, but when we're dealing particularly with more ambiguous predicate acts, or larger scale predicate acts like accounting fraud, how close to the conduct of the enterprise does the defendant have to be in order to be liable? And that's a question that the Supreme Court answered in Reves versus Ernst & Young. In Reves, a farm and cooperative's bankruptcy trustee brought RICO claims against a predecessor to Ernst & Young, arguing that certain activities related to the accountant's auditing amounted to predicate acts under the RICO statute. Reves limited the reach of 1962(C) by holding that conducting the affairs or participating in conducting of an enterprise is limited to persons who have a managerial role in the enterprise's affair.

The court said in order to participate directly or indirectly in the conduct of such enterprise's affairs, one must have some part in directing those affairs. Seems easy enough as the Supreme Court puts it, but in application, that is a tough standard to apply to idiosyncratic facts, and courts throughout the country have reached non-uniform results on what Reves actually instructs. So we know the defendant must be aware of the enterprise's conduct and play some role on behalf of the enterprise. But again, the circuits that have applied haven't reached the same decisions about what actually amounts to operating or directing an enterprise. Fortunately for us lawyers out there, when a defendant is a professional, such as an accountant or an attorney, the mere provision of services doesn't make somebody a part of the enterprise.

But when courts start to see discretionary authority in operating the enterprise, actually making decisions on their own, that starts to look more like operating the affairs of the enterprise. Some courts have asked an even more particularized question, was the person integral to the enterprise's activities. A significant area of dispute among courts is whether somebody is just following instructions. Some courts have held that that's sufficient to meet the requirements of RICO. So if somebody's just carrying out orders, that can make somebody a defendant. Others have said that the simple taking of directions and performance of tasks that are necessary or helpful to the enterprise without more is insufficient.

Cal Stein: Yeah, thanks Sam. So one of the things Reves really tried to do is create a bright line, between enterprise insiders, as they've sometimes been called, and enterprise outsiders, when analyzing whether they, as RICO defendants, can be found to have conducted the affairs of the enterprise. While the Supreme Court tried to create this bright line, as you noted, Sam, it ended up not really doing so, but let's take a minute and talk about this insider outsider distinction. The Supreme Court defined insiders as people who have a formal position within the enterprise, and outsiders as those who do not. In Reves, as you noted, they were talking about an outside accounting firm. The bright line the Supreme Court tried to create is that "complete outsiders do not satisfy the test." They manage their own affairs, not the enterprise's.

However, where to draw that line has proven difficult, not just for courts since Reves, but for the Supreme Court in Reves itself. Although the Supreme Court said complete outsiders do not satisfy the test, it also said that being an outsider in and of itself is not an automatic bar to being a defendant in a 1962(C) case. So right away we have subclasses of outsiders. Are you a complete outsider or are you just a regular outsider? Ultimately, as it often does, the Supreme Court found that this is a question of degree. As to an outsider, if the person's professional activities went beyond what one would expect in the routine provision of professional services, then he or she could be liable for conducting the affairs of the enterprise under 1962(C). Another way of looking at this is to see how "intertwined" the outsider is with the enterprise. If he or she is very intertwined, it's more likely that he or she will be said to conduct the affairs, even without a formal position therein.

So really what types of outsiders are we talking about? Well, in the years since we've seen accountants, attorneys, bankers, auditors, all manner of professional service providers being brought in or attempted to be brought in by RICO plaintiffs to varying degrees of success, depending on the facts of the case. And with that, I think we are about out of time here today. So I want to bring this discussion of the RICO enterprise element to a conclusion. I want to thank you, Sam, for joining me on this podcast. I also want to thank everyone for listening. I hope you will join us for our next regularly scheduled installment in which we'll be discussing the pattern of racketeering activity element. If you have any thoughts or comments about this series, I invite you to contact me directly at callan.stein@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.