Pattern Element Is Still Crucial To Defending RICO Cases

By **Callan Stein, Christopher Carlson and Mary Grace Metcalfe** (September 15, 2022)

As the U.S. Supreme Court said more than 30 years ago in Agency Holding Corp. v. Malley-Duff and Associates Inc., "[T]he heart of any RICO complaint is the allegation of pattern of racketeering."[1]

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Agency Holding was one of a long line of cases exploring the pattern element. The statement holds true today: The pattern element remains the proverbial heart of the beast that is the Racketeer Influenced and Corrupt Organizations Act.

For a contemporary and high-profile example of this, we need look no further than the recently concluded RICO case in the U.S. District Court for the Northern District of Illinois, U.S. v. Smith.[2]

This case was one of several the U.S. Department of Justice brought concerning a large so-called commodities spoofing scheme.[3]

In it, the government indicted and tried four individuals for their participation in the spoofing scheme. In addition to charges of spoofing and fraud, the DOJ also charged the Smith defendants with engaging in a RICO conspiracy.

From the outset, the defense team focused on the pattern element of the RICO charge. And, though the court denied the defendants' motion to dismiss the RICO conspiracy count, the jury — who did convict the defendants of spoofing — ultimately acquitted them of violating RICO.

Below, we examine both the history of the pattern element as well as the U.S. v. Smith case, which serves as a terrific illustration of how important the pattern element remains to this day, and how critical it can be to attacking and defending RICO charges, even as prosecutors and civil plaintiffs modernize their RICO theories of liability.

Courts have noted that the "breathtaking" scope of RICO[4] can operate to undermine motions to dismiss defendants may bring early in a case, particularly in cases alleging schemes of long duration or broad impact.

However, defense counsel can nonetheless benefit from assessing whether the pattern element may be subject to substantive attack as the case progresses.

The more a practitioner can establish that the alleged criminal activity in question is, in the words of the U.S. Court of Appeals for the Seventh Circuit's in its 2006 Gamboa v. Velez decision, "garden variety fraud" rather than "organized and habitual criminal conduct,"[5] the greater the chances of convincing a judge or jury that the conduct does not rise to the level of a RICO violation.

This is especially true when a prosecutor's or plaintiff's case involves a novel theory of liability, as was the case with the financial spoofing alleged in U.S. v. Smith.

RICO's Pattern of Racketeering Activity Element

The RICO statute, Title 18 of the U.S. Code, Section 1961, defines the pattern element as follows:

> "[P]attern of racketeering activity" requires at least two acts of racketeering activity, in one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity.

In theory, this definition appears helpful insofar as it sets forth requirements for (1) multiple racketeering acts (2) that occurred within a defined period of time. However, as is often the case in the law, taking this theoretical rule and applying it practically to the specific facts of cases proved difficult for courts.

In particular, federal courts have long recognized that this simple definition, combined with dozens of types of racketeering acts recognized by the RICO statute[6] — e.g., murder, money laundering, arms trafficking, misuse of travel documents, illegal gambling, and a variety of different types of fraud — brings a wide range of conduct under the umbrella of RICO.[7]

Disparate and inconsistent judicial interpretations by districts and circuits arose almost immediately after the enactment of RICO, and, as a result, the U.S. Supreme Court has twice attempted to provide clarity on what is necessary to establish a pattern of racketeering activity.

In 1985, the Supreme Court decided Sedima SPRL v. Imrex Co. Inc.,[8] a case involving a dispute between joint venturers over allegedly inflated bills.

Prior to Sedima, lower courts developed certain restrictions to limit how broadly the RICO statute could be applied. In Sedima, the Supreme Court rejected many of these restrictions and clarified the broad scope of the RICO statute, but suggested, in dicta, that lower courts looking for ways to limit RICO's reach may have overlooked the pattern element as a way of doing so.

In the now-infamous footnote 14 of the Sedima decision, the Supreme Court parsed the words in RICO's definition of "pattern of racketeering activity," explaining that a pattern requires at least two acts of racketeering activity, not that it means two such acts.

From this, the Supreme Court announced a new rule regarding the pattern element: "[W]hile two acts are necessary, they may not be sufficient."[9]

Relying on the legislative history of RICO, the Supreme Court elaborated that "'[t]he target of [RICO] is ... not sporadic activity,'" and thus "'[i]t is this factor of continuity plus relationship which combines to produce a pattern.'"[10]

Footnote 14 did not provide the clarity the Supreme Court envisioned. Federal courts across the country applied Sedima with drastically different outcomes.

At one end of the spectrum, the U.S. Court of Appeals for the Eighth Circuit developed a pattern test that required proof of multiple schemes as opposed to merely multiple acts within a single scheme,[11] while the U.S. Court of Appeals for the Fifth Circuit, at the other end, chose to cling to the notion — which the Supreme Court thought it had rejected in

Sedima — that a pattern required only two racketeering acts.[12]

Other circuits settled on some type of multifactor test that considered a variety of new factors in determining whether a pattern existed, including the number and type of predicate acts, the time over which they were committed and the number of victims.

To resolve this disagreement, merely four years after deciding Sedima, the Supreme Court again tried to clarify the pattern element in HJ Inc. v. Northwestern Bell Telephone Co.[13]

Acknowledging that "developing a meaningful concept of 'pattern' within the existing statutory framework has proved to be no easy task," but was "nevertheless, a task [it] must undertake," the Supreme Court began its task by stating what a pattern was not, explicitly rejecting the formulations out of the Fifth and Eighth Circuits:

> We find no support … that predicate acts of racketeering may form a pattern only when they are part of separate illegal schemes. Nor can we agree with those courts that have suggested that a pattern is established merely by proving two predicate acts.[14]

Turning to what a pattern is, the Supreme Court analyzed Congress' intent in enacting RICO, stating:

> RICO's legislative history reveals Congress' intent that to prove a pattern of racketeering activity a plaintiff or prosecutor must show that the racketeering predicates are related, and that they amount to or pose a threat of continued criminal activity.[15]

Thus, the court endeavored to build upon the test it announced in Sedima, the "continuity plus relationship" test for establishing a pattern.

The court addressed the relatedness prong first. Borrowing from another section of the Organized Crime Control Act — which included RICO within it — the court held that racketeering acts are related if they "have the same or similar purposes, results, participants, victims, or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events."

The court then addressed the continuity prong. Unlike the relatedness prong, the court had no other language in the act on which to rely.

In its absence, the court offered its own formulation of what constituted continuity, identifying two separate methods for proving it: closed-ended continuity, i.e., racketeering activity that occurred over a specific, closed period of time; and open-ended continuity, i.e., racketeering activity that remained ongoing and threatened to continue.

Both Sedima and HJ Inc. are, of course, now in the distant past. But their legacies remain intact, as both decisions have continued to form the backbone of federal jurisprudence concerning RICO's pattern element in the more than 30 years since the Supreme Court decided them.

While the specific rules vary from circuit to circuit, both cases remain the lodestars by which federal courts frequently analyze and decide arguments about RICO's pattern element.

U.S. v. Smith

The recent spoofing case of U.S. v. Smith provides an excellent illustration of how RICO's pattern element continues to take center stage as the fulcrum on which RICO cases often turn.

Spoofing refers to the unlawful practice of placing an order to buy or sell a security, with the intent of canceling that order prior to execution, for the purpose of manipulating or influencing the market.

While spoofing charges have become more common, they are still somewhat rare. What sets U.S. v. Smith apart — and what made it deserving of the national coverage it received — is that in addition to charging the defendants with spoofing, the government also included RICO conspiracy charges under Title 18 of the U.S. Code, Section 1962(d).

Specifically, the DOJ alleged that when the defendants intended to buy precious metals, they placed spoofed orders to sell in order to lower the market price for their contract to buy, while if they were looking to sell, they placed spoofed orders to buy in order to artificially inflate the price at which they could sell.[16]

In addition to providing the basis for counts of price manipulation, wire fraud and commodities fraud, the DOJ relied on these transactions — alleged to have taken place between March 2008 and August 2016 — in describing the pattern allegedly underlying the RICO conspiracy count.[17]

The defense took aim at the RICO charge, focusing on the pattern element at the motion to dismiss stage, specifically on the continuity prong.[18]

Relying on case law holding that courts "rarely find a pattern of racketeering" when there is a "single overall scheme," defendants argued that the spoofing allegations lacked continuity and, thus, did not constitute a pattern.[19]

The district court disagreed, holding that "the number of schemes is only one consideration, and multiple schemes are not necessary to establish a pattern of racketeering."[20]

Rather, the district court found that other factors weighed in favor of finding continuity. These factors included the duration, or in this case, eight years; the number and variety of predicate acts, i.e., thousands of trades involving dozens of specific trading sequences; and the number of victims, which the district court said was significant, since the case involved alleged fraud on the commodities market as a whole.[21]

All of this, the district court found, would "be for a jury to decide."[22]

Ultimately, a jury did decide the case. And while the jury convicted the defendants of the spoofing charges, it acquitted them of the RICO charge.

While we cannot say for sure why the jury acquitted the defendants of the RICO charge, there is a compelling case to be made that it was because of the pattern element.

Certainly, by virtue of convicting the defendants of spoofing, the jury felt the government proved criminal conduct. That the jury decided the government did not prove the RICO charge suggests they found its proof concerning one of the RICO-specific elements — such as a pattern of racketeering activity — lacking.

Given the primacy of the pattern element to the defense team's attack of that charge throughout the case, it is possible, if not likely, that it contributed to the acquittal.

Regardless of whether the pattern element was or was not the deciding factor for the acquittal, and whether or not it was for the same reasons that have long inspired trepidation among federal courts, U.S. v. Smith provides both a unique illustration of how the pattern element remains important today and a graphic demonstration of the very real benefits that can be realized by defense counsel if they attack that element early in a case.

Even where, as in U.S. v. Smith, defense counsel's motion to dismiss RICO charges for lack of a pattern of racketeering activity is denied, the sharp and continued focus on that element, and the identification of deficiencies in the ability of prosecution's or plaintiff's evidence to prove it, can reap major benefits in the case, up to and including possibly contributing to a RICO acquittal where the jury did find criminal conduct occurred.

Even though Sedima and HJ Inc. feel like ancient history, the pattern element remains a viable point of attack for defense counsel even as prosecutors and civil plaintiffs modernize their use of RICO to include novel theories of liability like financial spoofing.

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[1] Agency Holding Corp. v. Malley-Duff & Assoc., Inc., 438 U.S. 143 (1987).

[2] U.S. v. Smith, et al., 19-CR-00669.

[3] See also U.S. v. Edmonds, 3:18-cr-00239 (D. Conn.); U.S. v. Trunz, 19-CR-00375 (E.D. N.Y.).

[4] R.A.G.S. Couture, Inc. v. Hyatt, 774 F.2d 1350, 1355 (5th Cir. 1985).

[5] Gamboa v. Velez, 457 F.3d 703, 710 (7th Cir. 2006).

[6] 18 USC 1961(5).

[7] See, e.g., R.A.G.S. Couture, Inc. v. Hyatt, 774 F.2d 1350, 1355 (5th Cir. 1985) (describing the scope of RICO as "breathtaking.").

[8] Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 105 S. Ct. 3275, 87 L. Ed. 2d 346 (1985).

[9] Sedima, 473 U.S. at 497, n.14.

[10] Id.

[11] Superior Oil Co. v. Fulmer, 785 F.2d 252, 254 (8th Cir. 1986).

[12] R.A.G.S. Couture, Inc. v. Hyatt, 774 F.2d 1350, 1355 (5th Cir. 1985).

[13] H.J. Inc. v. Nw. Bell Tel. Co., 492 U.S. 229, 109 S. Ct. 2893, 106 L. Ed. 2d 195 (1989).

[14] H.J. Inc. 492 U.S. at 236.

[15] Id. at 239 (emphasis in the original).

[16] Smith, Doc. 448 ¶ 26.

[17] Id., Docs. 1, 52, 448.

[18] Id. Doc. 114.

[19] Id. at 40 (quoting Miller v. Loucks, 1992 WL 329313 (N.D. Ill. Nov. 5, 1992), at *10).

[20] Id., Doc. 374 at 25.

[21] Id. at 27 ("the quantity and variety in victims and injuries favor continuity too").

[22] Id.