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Defending RICO Claims After *Boyle v. United States*

By J. Douglas Grimes and C. Bailey King, Jr.

The fundamental principles that have historically led courts to dismiss RICO claims remain valid.

In today's litigation environment, businesses are increasingly faced with lawsuits alleging violations of the Federal Racketeer Influenced and Corrupt Organization Act (RICO), often based on seemingly routine and legitimate commercial dealings. *See* 18 U.S.C. §§1961–1968 (2010). The purpose of RICO was to "seek the eradication of organized crime in the United States" and to "curb the infiltration of legitimate business organizations by racketeers." Pub. L. No. 91-452, 84 Stat. 922 (1970); *Atlas Pile Driving Co. v. DiCon Fin. Co.*, 886 F.2d 986, 990 (8th Cir. 1989). Obviously, routine commercial dealings between two businesses fall outside of RICO's intended scope. That said, the language of the act is expansive, and Congress has mandated that RICO must be "liberally construed to effectuate its remedial purpose." Pub. L. No. 91-452, §904(a), 84 Stat. 947 (1970). Defense lawyers in commercial disputes, therefore, must attempt to distinguish the routine business affairs of their clients from the type of conduct that RICO was actually intended to prohibit. As discussed below, this has become a more difficult task in light of the Supreme Court's recent decision in *Boyle v. United States*.

Under section 1962(c) of RICO, it is unlawful for "any person 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." 18 U.S.C. §1962(c) (2010). The elements of a claim under this statute are "(1) conduct (2) of an enterprise (3) through a pattern, (4) of racketeering activity." *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 496 (1985). Under the act, "racketeering activity" is defined to include a wide variety of criminal offenses enumerated as "predicate acts" in section 1961. These predicate acts range from murder to mail fraud. 18 U.S.C. §1961(1). The inclusion of mail fraud as one of RICO's predicate acts means that nearly all claims of commercial fraud will also involve "racketeering activity," as all businesses use the mail system to further their business.

RICO is primarily a criminal statute designed to combat the activities of Mafia-

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like organizations whose widespread criminal activity could not be fully punished under traditional criminal laws. In this context, courts clearly need to construe RICO broadly to "achieve results consistent with Congress's goal of protecting legitimate businesses from infiltration by organized crime." *Schmidt v. Fleet Bank*, 16 F. Supp. 2d 340, 345 (S.D.N.Y. 1998) (internal quotations omitted). In addition to criminal liability, however, RICO also permits plaintiffs to pursue civil actions that allow them to recover both treble damages and attorneys' fees. 18 U.S.C. §1964 (2006). Due to the threat of these large penalties, RICO's expansive breadth is troubling because it increases defendants' litigation risks in routine commercial disputes. Moreover, because of its criminal purpose, the "mere assertion of a [civil] RICO claim… has an almost inevitable stigmatizing effect on those named as defendants." *Katzman v. Victoria's Secret Catalogue*, 167 F.R.D. 649, 655 (S.D.N.Y. 1996), *aff'd*, 113 F.3d 1229 (2d Cir. 1997). As a result, "[c]ivil RICO is an unusually potent weapon—the litigation equivalent of a thermonuclear device." *Id.* With this in mind, defense lawyers in commercial cases must attack the merits of these claims as early as possible, often during the motion to dismiss stage.

In the past, courts have been receptive to motions to dismiss civil RICO claims if the claims were based solely on allegations of fraud in routine business transactions. As the Fourth Circuit noted, courts "should not lightly permit ordinary business contract or fraud disputes to be transformed into federal RICO claims." *Flip Mortgage Corp. v. McElhone*, 841 F.2d 531, 538 (4th Cir. 1988). In June 2009, however, the Supreme Court issued a sweeping opinion in the criminal case of *Boyle v. United States*, seemingly expanding the types of civil disputes that fall within RICO's scope. *See* 129 S. Ct. 2237 (2009). Since that time, district courts have been more reluctant to dismiss civil RICO claims, even those arising from ordinary commercial relationships.

Nonetheless, commercial lawyers should not abandon the argument that RICO does not cover routine business transactions. Instead, commercial lawyers should simply restructure the argument to fit the *Boyle* framework and to refocus on the other elements of a civil RICO claim. Because RICO's breadth can have unintended consequences in civil suits, courts should still "strive to flush out frivolous RICO allegations at an early stage of the litigation" and "lookout for the putative RICO case that is really nothing more than an ordinary fraud case clothed in the Emperor's trendy garb." *Schmidt v. Fleet Bank*, 16 F. Supp. 2d 340, 346 (S.D.N.Y. 1998). The purpose of this article is to highlight arguments available for the dismissal of civil RICO claims that were not foreclosed by the Supreme Court's holding in *Boyle*.

The "Enterprise" Element

One of the most frequently litigated issues in civil RICO cases has been whether routine commercial dealings between distinct business entities can constitute a RICO enterprise. The RICO statute broadly defines an enterprise to include "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). Identifying and proving that a corporation, partnership, or other legal entity is an enterprise generally is a straightforward task. In most RICO cases, however, the alleged enterprise will consist of a group of individuals or entities that allegedly worked together to achieve a common objective. RICO's statutory language does not provide any guidance on the essential features of these "association-in-fact" enterprises.

The Supreme Court's primary guidance on this issue came nearly 30 years ago in *United States v. Turkette*, which described an association-in-fact enterprise as "a group of persons associated together for a common purpose of engaging in a course of conduct." 452 U.S. 576, 581 (1981). Such an enterprise is "proved by evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit." *Id.* at 583. The Court further stated that the existence of an association-in-fact enterprise is "an element separate and distinct from the pattern of racketeering activity." *Id.* Thus, although the Court recognized that the "proof used to establish these separate elements may in particular cases coalesce," it confirmed that for RICO purposes, an enterprise must exist separate and apart from the pattern of racketeering activity in which it engages. *Id.* Accordingly, "proof of one does not necessarily establish the other." *Id.*

After *Turkette*, circuit courts split sharply on what was required to establish the existence of a RICO enterprise. The First, Second, Ninth, Eleventh, and D.C. Circuits held that an enterprise did not require any particular organizational structure. 7 Jerold S. Solovy & R. Douglas Rees, Bus. & Com. Litig. Fed. Cts. §80:18 (2d ed. 2009). The majority of circuits, however, concluded that *Turkette* required an enterprise to have some identifiable structure or hierarchy, as well as an ongoing, legitimate purpose that would distinguish its activity from a mere conspiracy. *Id.* The effect of this requirement was to remove many commercial relationships and arm's-length business transactions from RICO's scope.

The language of the act is expansive, and Congress has mandated that RICO must be "liberally construed to effectuate its remedial purpose."

The *Boyle* Decision

In 2009, the Supreme Court sought to address this circuit court split and to clarify the elements of an association-in-fact enterprise in the case of *Boyle v. United States*, 129 S. Ct. 2237 (2009). In *Boyle*, the defendant was part of a core group of loosely and informally organized criminals that carried out more than 30 bank robberies in several states. *Id.* at 2241. In each of the robberies, the group "met beforehand to plan the crime, gather tools (such as crowbars, fishing gaffs, and walkie-talkies), and assign the roles that each participant would play (such as lookout and driver)." *Id.* The group did not, however, have a leader, a hierarchy, or a long-term master plan. *Id.* The trial jury convicted

the defendant of various crimes, including RICO violations. The defendant appealed his conviction based on the trial court's failure to instruct the jury that, to prove the existence of a RICO enterprise, the government was required to prove that the defendant's criminal gang had "an ascertainable structure distinct from the charged predicate acts." *Id.* at 2241–42.

The Court rejected the notion that a RICO enterprise requires a hierarchy, a chain of command, fixed roles, regular meetings, or rules and regulations.

In sweeping language, and without overturning *Turkette*, the Court held that an association-in-fact RICO enterprise is simply "a continuing unit that functions with a common purpose." *Boyle*, 129 S. Ct. at 2245. The Court rejected the notion that a RICO enterprise requires a hierarchy, a chain of command, fixed roles, regular meetings, or rules and regulations. *Id.* Instead, the Court held that an association-in-fact enterprise only needs three structural features: (1) "a purpose," (2) "relationships among those associated with the enterprise," and (3) "longevity sufficient to permit these associates to pursue the enterprise's purpose." *Id.* at 2244.

On its face, the *Boyle* decision is concerning to commercial litigation defendants because the three structural features that it identifies as features of a RICO enterprise arguably encompass nearly every mutually beneficial commercial transaction, even those entered into at arm's length. However, *Boyle* does not foreclose the argument that ordinary business relationships, without more, remain beyond RICO's reach. In particular, *Boyle* examined the sufficiency of criminal jury instructions, not the pleading requirements for civil RICO claims. *Boyle*, therefore, does not preclude dispositive motions for failure to adequately plead the existence of a RICO enterprise. Moreover, *Boyle* does not reject or overturn the holdings of many cases dismissing civil RICO claims on other grounds. Accordingly, defense counsel can adjust their arguments in light of *Boyle* to show why routine commercial disputes still fall outside of RICO's scope.

Pleading the Existence of a RICO "Enterprise" After *Boyle*

Even after *Boyle*, plaintiffs in a civil RICO case must plausibly allege the existence of an enterprise. A RICO complaint requires more than simply a list of entities and activities strung together and labeled as an association-in-fact enterprise. *See, e.g., Richmond v. Nationwide Cassel, L.P.*, 52 F.3d 640 (7th Cir. 1995). Moreover, conclusory or speculative allegations that an enterprise exists, standing alone, are insufficient to defeat a motion to dismiss. *See, e.g., Ass'n of Cleveland Firefighters v. City of Cleveland, Ohio*, 502 F.3d 545 (6th Cir. 2007). Instead, a plaintiff must allege facts that, if proven, would establish that the defendants "associated together for the purpose of engaging in a course of conduct" and that they formed an "ongoing organization, formal or informal" that "function[ed] as a continuing unit" to achieve a common purpose.

Because *Boyle* confirms the existence of an enterprise is a separate element that must be proven under RICO, defense counsel should seek immediate dismissal of any RICO complaint that fails to allege that an enterprise entity existed and functioned distinct from its constituent members. Indeed, to state a valid claim under RICO, a plaintiff must allege that the defendants "formed and organized a separate entity (formal or informal) on whose behalf they acted; it is not enough if they merely acted together to commit the wrong." *Greenberg v. Blake*, No. 09 Civ. 4347(BMC), 2010 WL 2400064 (E.D.N.Y. June 10, 2010). Furthermore, to be liable under RICO, a defendant must have controlled or conducted the affairs of the enterprise, not merely its own affairs. *See, e.g., Crichton v. Golden Rule Ins. Co.*, 576 F.3d 392 (7th Cir. 2009). Following *Boyle*, a plaintiff's failure to plead both the formation and separate operation of a distinct enterprise entity should remain fatal to a RICO claim. *See, e.g., Ouwinga v. John Hancock Variable Life Ins.*, No. 1:09cv60, 2010 WL 4386931 (W.D. Mich. Oct. 29, 2010) ("A RICO enterprise alleged as associated-in-fact must be pled as existing separately from the defendants' activity; it may not merely consist of the named defendants."); *Myers v. Lee*, No. 1:10cv131, 2010 WL 3745632 (E.D. Va. Sep. 21, 2010) (dismissing RICO claim where complaint failed to allege "a RICO enterprise that operates or functions in a way distinct from the defendants themselves"). By focusing on the distinctiveness of the enterprise as a whole and its alleged individual members, defense counsel can prevent plaintiffs from improperly characterizing the mere joint commission of wrongful acts as a RICO enterprise.

In addition, while *Boyle* appears to set a low threshold for pleading a RICO enterprise, courts should not read it so broadly that it brings routine commercial dealings or contractual relationships within RICO's scope. *Boyle* confirmed that a RICO enterprise must have some structure, although it is unclear the extent to which that structure must be ascertainable in civil cases. Following *Boyle*, some courts still examine the framework of the alleged enterprise to determine whether its members functioned as a "continuing unit." *See, e.g., Conte v. Newsday*, 703 F. Supp. 2d 126 (E.D.N.Y. 2010); *Freund v. Lerner*, No. 09 CV 7117(HB), 2010 WL 3156037 (S.D.N.Y. Aug. 10, 2010). Similarly, some courts continue to reject civil RICO claims if all of the alleged enterprise members are not plausibly alleged to have worked together in a coordinated manner to achieve a common goal. *See, e.g., Rao v. BP Prods. N. Am., Inc.*, 589 F.3d 389, 400 (7th Cir. 2009) (upholding dismissal of RICO claims because, among other reasons, the plaintiff's allegations of an association-in-fact enterprise "do not indicate how the different actors are associated and do not suggest a group of persons acting together for a common purpose or course of conduct"); *Greenberg v. Blake*, 2010 WL 2400064, at *4 (a plaintiff "must provide solid information regarding the hierarchy, organization, and activities of the alleged enterprise, from which the court could fairly conclude that its members functioned as a unit.... Lack of proof of such an independently existing separate enterprise dooms a RICO claim").

Although the courts may not have clearly defined a RICO enterprise's structure, defendants should continue to focus on the lack of structure inherent in arm's-length business transactions in arguing for immediate dismissal of civil RICO claims.

Pleading "Conduct" of an Enterprise After *Boyle*

In light of *Boyle*'s broad and undifferentiating holding, commercial litigators defending RICO claims should not focus their defense solely on whether a RICO enterprise has been properly alleged. Instead, defense attorneys should closely scrutinize a plaintiff's factual allegations to determine whether they establish the other elements of a RICO claim. In doing so, the "conduct" element may provide a court with the strongest argument for immediately dismissing a civil RICO complaint. Under this element, mere association with an enterprise does not make a defendant liable under RICO. Instead, to be liable under the statute, a defendant must "conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity." 18 U.S.C. §1962(c). Thus, even if an enterprise is appropriately pled, a plaintiff must also allege that each of the defendants "conducted or participated" in the enterprise's affairs. In applying this standard, courts have construed the "conduct" element more restrictively than the plain language of the statute at first would suggest.

In *Reves v. Ernst & Young*, the Supreme Court held that RICO's conduct element requires a defendant to "have some part in directing [the enterprise's] affairs." 507 U.S. 170 (1993). More precisely, "one is not liable under [§1962(c)] unless one has participated in the operation or management of the enterprise itself" and done so "through a pattern of racketeering activity." *Id.* at 183. "An enterprise is operated not just by upper management but also by lower rung participants in the enterprise who are under the direction of upper management." *Id.* at 184. "Outsiders" may also meet this statutory requirement, but only if they "exert control over" the enterprise such that they "conducted or participated in the conduct of the *enterprise's* affairs, not just their *own* affairs." *Id.* at 184–85. Based on this analysis, the Supreme Court in *Reves* found that an outside accounting firm hired to audit an enterprise's books did not "participate, directly or indirectly, in the conduct" of the enterprise's affairs simply by doing its job, even if it performed its job deficiently and its work related to the alleged unlawful conduct. *Id.* at 185–86. Thus, the relationship between a company and its outside auditor was insufficient to support RICO liability.

Boyle expressly acknowledged the validity of *Reves* and confirmed that the *Boyle* holding did not address RICO's "conduct" element. Thus, the *Reves* holding, particularly its observation that a defendant cannot be liable under RICO simply for conducting his or her own separate affairs, is significant in arguing against civil RICO claims based on routine commercial dealings. Though some courts have described *Reves*' "operation or management" test as establishing a "relatively low hurdle" for a plaintiff to clear at the pleading stage, a RICO defendant must have exerted some degree of control over the management and decisions of the enterprise to face potential liability. *See, e.g., Conte v. Newsday*, 703 F. Supp. 2d 126 (E.D.N.Y. 2010). Based on this test, several courts have concluded that "simply having a business relationship with or performing valuable services for an enterprise, even with knowledge of the enterprise's ilicit nature, is not enough to subject an individual to RICO liability." *See, e.g., In re: Mastercard Int'l. Inc.*, 132 F. Supp. 2d 468, 487 (E.D. La. 2001), *aff'd*, 313 F.3d 257 (5th Cir. 2002).

Consequently, the "conduct" standard pronounced in *Reves* may be fatal to RICO claims based solely on contractual relationships, vendor-vendee transactions, or other mutually beneficial commercial relationships, even those used to facilitate alleged illegal conduct. *See, e.g., Arenson v. Whitehall Convalescent & Nursing Home, Inc.*, 880 F. Supp. 1202 (N.D. Ill. 1995) ("allegations of a simple supplier-purchaser relationship are insufficient to allege... the operation or management of [a RICO enterprise]"); *see also Jubelirer v. Mastercard Int'l, Inc.*, 68 F. Supp. 2d 1049 (W.D. Wis. 1999); *Stone v. Kirk*, 8 F.3d 1079 (6th Cir. 1993); *Biofeedtrac, Inc. v. Kolinor Optical Enterprises & Consultants, S.R.L.*, 832 F. Supp. 585 (E.D.N.Y. 1993); *Jackson v. Sedgwick Claims Mgmt. Srvcs., Inc.*, No. 09-11529, 2010 WL 931864 (E.D. Mich. Mar. 11, 2010). Even in jurisdictions where courts apply a broad reading of *Boyle*'s "enterprise" pleading requirements, defense counsel can and should argue that courts should follow *Reves* strictly to prevent RICO from encroaching far beyond its intended purpose into routine commercial transactions and disputes.

Courts have held that proof of two acts of racketeering activity alone is insufficient to establish a pattern. ... Instead, a plaintiff also must offer proof that the predicate acts were continuous and interrelated.

Pleading a Pattern of Racketeering Activity After *Boyle*

Similarly, in light of *Boyle*, it is worthwhile for defense lawyers to reexamine what constitutes a pattern of racketeering activity. Under RICO's plain, statutory language, a plaintiff may satisfy this pleading element if the defendant committed "at least two acts of racketeering activity" within 10 years of one another. 18 U.S.C. §1961(5). As a result of this low bar, defense lawyers in the past often elected not to defend civil RICO claims by challenging this element.

However, despite its broad statutory definition, courts have held that proof of two acts of racketeering activity alone is insufficient to establish a pattern. *See* Cory P. Argust, *Racketeer Influenced and Corrupt Organizations*, 47 Am. Crim. L. Rev. 961, 967–68 (2010). Instead, a plaintiff also must offer proof that the predicate acts were continuous and interrelated. *Id.* As a result, a plaintiff does not adequately plead a pattern of racketeering activity simply by alleging two predicate acts. Instead, a plaintiff must also allege facts that establish

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"continuity" and a "relationship" between those acts. *Sedima, S.P.R.L.*, 473 U.S. at 496, n.14. Ordinarily, the "relationship prong of this analysis is not difficult to meet—a plaintiff must merely show that the predicate acts have similar purposes, results, victims, methods of commission, or are otherwise interrelated by distinguishing characteristics." *Kriston v. Peroulis*, No. 09-CV-00909, 2010 WL 1268087, at *8 (D. Colo. Mar. 29, 2010). A plaintiff has more difficulty, however, establishing that those acts are continuous, which is a "centrally temporal concept" that arises from "Congress's desire to limit RICO's application to ongoing unlawful activities whose scope and persistence pose a special threat to social well-being." *U.S. Airline Pilots Assoc. v. Awappa, LLC*, No. 08-1858, 2010 WL 2979322, at *4 (4th Cir. July 30, 2010).

The Supreme Court has explained that "[c]ontinuity is both a closed- and open-ended concept, referring either to a closed period of repeated conduct, or to past conduct that by its nature projects into the future with a threat of repetition." *H.J. Inc. v. Nw. Bell Tel. Co.*, 492 U.S. 229, 241 (1989). To allege closed-ended continuity, a plaintiff must allege facts showing that a "series of related predicate[] [acts] extend over a substantial period of time." *Id.* To allege open-ended continuity, on the other hand, a plaintiff must "plead facts that... give rise to a reasonable expectation that the racketeering activity will extend indefinitely into the future." *See U.S. Airline Pilots Assoc.*, 2010 WL 2979322, at *4 (quoting *H.J. Inc.*, 492 U.S. at 242.) Because commercial transactions will typically involve a finite contractual term, such as with a license agreement, or will have an isolated nature, such as with purchase agreements, defense counsel should closely examine the duration of the predicate acts and the risk that those acts will continue into the future. This fact-specific analysis of RICO's pattern element may provide another argument that can "ensure that RICO's extraordinary remedy does not threaten the ordinary run of commercial transactions." *Id.* at *3.

Conclusion

Although the Supreme Court in *Boyle* attempted to resolve the split among the circuits regarding what is required to prove a RICO enterprise, its vague holding provides little guidance for commercial litigants. Given RICO's intentionally broad statutory language, it is likely that courts will continue to struggle with whether ordinary commercial relationships should give rise to civil RICO liability. *Boyle* may make it more difficult to argue that these relationships are insufficient to satisfy RICO's enterprise element, but defense attorneys should not view this decision as a watershed change in the law. The fundamental principles that have historically led courts to dismiss civil RICO claims remain valid. Put simply, RICO was not intended to cover garden-variety commercial disputes, even those involving the joint commission of fraudulent activity. Accordingly, defense counsel in commercial cases should continue to pursue motions to dismiss civil RICO claims. In doing so, though, defense lawyers will best serve clients if they focus on the RICO pleading requirements that *Boyle* does not address, rather than the difficulties created by its holding. FD

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of the evidence that Texas Instruments' infringement claims had a significant and adverse affect on Linear's ability to use the machines, were not "frivolous," and were not a result of the defendants' compliance with Linear's specifications. Linear argued that since the mere prospect of litigation establishes the first prong of the test, the fact that it was actually sued by Texas Instruments for patent infringement indicated that Linear's ability to use the purchased equipment was significantly and adversely affected.

Next, Linear attempted to establish that Texas Instruments' patent infringement claims were not "frivolous." Relying on *Pacific Sunwear*, Linear argued that it did not have to show that Texas Instruments would have ultimately won its patent infringement case, but that Texas Instruments' claims were not "totally and completely without merit." Among other things, Linear attempted to prove the "rightfulness" of the underlying patent infringement claims by offering into evidence Texas Instruments' claim charts, the fact that Texas Instruments' aggressively litigated its claims against Linear for almost two years, and the fact that Linear settled the underlying patent infringement claims on unfavorable terms because of the risk of an adverse result. Perhaps most strongly, Linear relied on the jury verdict in Texas Instruments' separate lawsuit against nonparty Hyundai determining that the use of *similar* semiconductor equipment by Hyundai had infringed the same Texas Instruments patents. Linear argued that the Hyundai verdict corroborated the rightful nature of Texas Instruments' claims against Linear.

To defend against Linear's allegations of the "rightfulness" of the underlying patent infringement claims, Tokyo Electron and Novellus had to present substantial evidence to support their contention that any claim that the operation of their equipment by Linear infringed Texas Instruments' patents was "frivolous," therefore, that the claim was not "rightful." To do so, the defendants examined the substance of the underlying patents, which specified that the infringing tools had to operate "asynchronously." The defendants' offered detailed, factual and expert testimony explaining why the equipment could not have operated in the manner described in Texas Instruments' patents. Specifically, the defendants showed that because their tools operated "synchronously," Texas Instruments underlying infringement claims were factually devoid of merit, that is, "frivolous." The defendants also presented evidence showing that no court, including the *Hyundai* court, had ever addressed whether Texas Instruments' infringement claim against Linear actually had any merit. Finally, the defendants showed that Linear never stopped using the defendants' equipment during the patent litigation, nor that it replaced that equipment, so the underlying litigation had no adverse effect on Linear's ability to use Tokyo Electron's and Novellus' equipment. Because Texas Instruments' infringement claims were factually and legally devoid of merit, and because they did not adversely affect Linear's ability to use the equipment, the defendants argued, Texas Instruments' claims were not rightful.